(1)

Supreme Court, U.S.
FILED

No. 98 823 OCT 28 1998

OFFICE OF THE CLERK

In the

Supreme Court of the United States

October Term, 1998

ROBERT G. LESLIE and MARILYN B. LESLIE,

Petitioners,

-v-

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

PETITION FOR A WRIT OF CERTIORARI

Kevin M. McGuire
Attorney for Petitioners
Law Office of Federico
Castelan Sayre
450 Newport Center Drive
Suite 650
Newport Beach, Ca 92660
(949) 721-0221

Dennis P. Derrick
Counsel of Record
Seven Winthrop Street
Essex, Ma 01929
(978) 768-6610

Appellate Service: Curry & Taylor (800) 222-8738/Appellate@webtv.com

♻

89 pp

Questions Presented.

1. Whether the court of appeals and the Tax Court may consistent with the Due Process Clause and Fed. R.Civ.P. 52(a) import into this proceeding crucial evidence not otherwise adduced below in order to provide a factual foundation for deciding that Leslie had invested in certain gold futures for tax savings instead of profit?

2. Can the court of appeals or the Tax Court properly rely upon expert evidence concerning the most cru- cial issue in this proceeding, i.e., the taxpayers' in- vestment motivations, when that expert has no spe- cialized knowledge, his opinion lacks foundation or objectivity and his conclusory opinion about motiva- tion is so estranged from the facts of this case that it could provide no assistance to the factfinder?

Table of Contents

Page

Questions Presented for Review i

Table of Contents ii

Table of Authorities iv

Citations of Opinions and Orders 1

Basis for Jurisdiction in This Court 1

Statutory and Constitutional Provisions Involved 1

Statement of the Case 3

Reasons for Granting the Writ 12

I.The Decision Below Misapplies And Emasculates The Decisions of This Court Which Define The Factfinding Function of The Trial Court And The Standard For Reviewing Those Findings Set Out in Fed.R.Civ. P.52(a). 12

II.The Reliance by the Courts Below on Alleged Expert Opinion Addressing the Most Crucial Issue in this Case, i.e., Leslie's Investment Motivation, Conflicts with this Court's Decisions Setting Forth the Requirements For the Admission of Such Evidence. 20

Conclusion 23

Appendix

Exhibit A - Circuit Court Opinion 1a

Exhibit B - District Court Order 21a

Exhibit C - Order Denying Rehearing 53a

Exhibit D - Statutory and Constitutional Provisions Involved 54a

Table of Authorities

Page

Cases

Anderson v. Bessemer City, 470 U.S. 564,575 (1985) 14

Berry v. City of Detroit, 25 F.3d 1342, 1349-1350 (6th Cir. 1994) 20, 21, 22

Bose Corp. v. Consumers Union of U.S. Inc., 466 U.S. 485, 499 (1984) 13

Cannizzo v. Farrell Lines, Inc., 579 F.2d 682, 686 (2nd Cir. 1978) 14

Coalition to Save our Children v. Bd. of Educ., 90 F.3d 752, 759 (3rd. Cir. 1996) 14

Commissioner v. Duberstein, 363 U.S. 278,292-293 (1960) 12

Communist Party of Indiana v. Whitcomb, 414 U.S. 441, 445-446 (1974) 12

Concrete Pipe & Products of Cal. Inc. v. Construction Laborers Pension Trust for Southern Cal., 508 U.S. 602, 622-623 (1993) 14

Connecticut v. Doehr, 501 U.S. 1.14 (1991) 19

Daubert v. Merrell Dow Pharmaceuticals, Inc., 509 U.S. 579, 590-593 (1993) 20, 22

Duty v. United States, 735 F.2d 1012, 1015 (6th Cir. 1984) 14

Ewing v. Commissioner, 91 T.C. 396 (1988), *aff'd without published opinion*, 940 F.2d 1534 (9th Cir. 1991) ..... *passim*

FTC v. Colgate-Palmolive Co., 380 U.S. 374, 384 (1965) 12

Featherstone v. Barash, 345 F.2d 246, 249-251 (10th Cir. 1965) 12

Fox v. Commissioner, 82 T.C. 1001(1984) 16, 18

Goldberg v. Kelly, 397 U.S. 254, 267(1970) 19

In re G.W. Giannini, Inc., 90 F.2d 445,447-448 (2d Cir. 1937) 13

Interstate Circuit v. U.S., 304 U.S. 55, 56-57 (1938) 12

Joint Anti-Fascist Refugee Comm. v. McGrath, 341 U.S. 123,170-172 (1951) 19

Kelley v. Everglades District, 319 U.S. 415, 420-422 (1943) 12

Laureys v. Commissioner, 92 T.C. 101,126-129 (1989) 21, 22

Lundgren v. Freeman, 307 F.2d 104,113-114 (9th Cir. 1962) 18

Matthews v. Eldridge, 424 U.S. 319,333 (1976) 19

Michelson v. Commissioner, T.C. Memo 1990-27 21

Nolte v. Commissioner, 69 T.C.M. 1828, 1829 (1995) 14

O'Connor v. Common wealth Edison Co., 13 F.3d 1090, 11006 (7th Cir. 1994) 20

Panaview Door & Window Co. v. Reynolds Metals Co., 255 F.2d 920,922-923 (9th Cir. 1958) 18

Perry v. United States, 755 F.2d 888, 890 (11th Cir. 1985) 22

Reed v. Sage Group. Inc., C.F.C.T. Docket No. 85-R312 (1986) 21

Robert G. Leslie et al. v. Commissioner of Internal Revenue, 71 T.C.M. (CCH) 2233 (2/28/96) 1, 8

Saginaw Broadcasting Co. v. Federal Communications Commission, 68 App. D.C. 282,286; 96 F.2d 554,559 (1938) 13

Salve Regina College v. Russell, 499 U.S. 225, 233 (1991) 14

See In re Scrap Disposal, Inc., 8 B.C.D.504, 505; 15 B.R. 296,297 (9th Cir. Bankruptcy App. 1981) 13

Stoller v. Commissioner, T.C. Memo. 1990-659; *rev'd on other grounds*, 994, F.2d 855 (D.C. Cir. 1993) 16

United States v. Healey, 376 U.S. 75, 77-78, 80 (1964) 12

United States v. One Assortment of 25 Firearms, 483 F.Supp.16,18-19 (E.D. Tenn.1980) 13

United States v. United States Gypsum Co., 333 U.S. 364, 395 (1948) 13

Wilson v. City of Chicago, 6 F.3d 1233, 1238-1239 (7th Cir. 1993) 21

Zimmerman v. Sloss Equipment, Inc. 72 F.3d 822,825(10th Cir. 1995) 14

Rules and Regulations

Equity Rule 70½ 12

Rule 52(a) ..... *passim*

Statutes

26 U.S.C. §7482 9

28 U.S.C. §1254(1). 1

28 U.S.C. §2101(c) 1

Deficit Reduction Act of 1984 Section 108 8

I.R.C. Section 165(c)(2) 8

Section 6621(c) of the Internal Code (Title 26) 8

Citations of Opinions and Orders.

The opinion of the United States Court of Appeals for the Ninth Circuit in *Robert G. Leslie et al. v. Commissioner of Internal Revenue*, ___ F.3d ___ (9th Cir. 1998), is set forth in the Appendix hereto (App. 1a-20a). The memorandum decision of the United States Tax Court in *Robert G. Leslie et al. v. Commissioner of Internal Revenue*, 71 T.C.M. (CCH) 2233 (2/28/96) is set forth in the Appendix hereto (App. 21a-52a).

The order of the United States Court of Appeals for the Ninth Circuit denying the petition of Robert G. Leslie et al. for rehearing is set forth in the Appendix hereto (App. 53a).

Basis for Jurisdiction in this Court

The final judgment of the United States Court of Appeals for the Ninth Circuit affirming the decision of the United States Tax Court was entered on July 30, 1998, in the wake of the court's denial of the Leslies' petition for rehearing (App. 53a). This petition for writ of certiorari is filed within 90 days of that date. 28 U.S.C. §2101(c).

The jurisdiction of this Court is invoked pursuant to the provisions of 28 U.S.C. §1254(1).

Constitutional and Statutory Provisions Involved

United States Constitution, Amendment V:

> No person shall. . .be deprived of life, liberty or property, without due process of law. . .

Federal Rule of Civil Procedure 52(a):

> In all actions tried upon the facts without a jury or with an advisory jury, the court shall find the facts specially and state separately its conclusions of law thereon, and judgment shall be entered pursuant to Rule 51. . . . Findings of fact, whether based on oral or documentary evidence shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the trial court to judge of the credibility of the witnesses....

Federal Rules of Evidence:

> *Rule 403. Exclusion of Relevant Evi dence on Grounds of Prejudice, Confu- sion, or Waste of Time.* Although relevant, evidence may be excluded if its probative value is substantially outweighed by the danger of unfair prejudice, confusion of the issues, or misleading the jury, or by considerations of undue delay, waste of time, or needless presentation of cumulative evidence.

Rule 702. Testimony by Experts.

If scientific, technical, or other specialized knowledge will assist the trier of fact to understand the evidence or to deter- mine a fact in issue, a witness qualified as an expert by knowledge, skill, experience, training, or education, may testify thereto in the form of an opinion of otherwise.

Rule 703. Bases of Opinion Testimony by Experts.

The facts or data in the particular case upon which an expert bases an opinion or inference may be those perceived by or made known to the expert at or before the hearing. If of a type reasonably relied upon by experts in the particular field in forming opinions or inferences upon the subject, the facts or data need not be admissible in evidence.

Statement of the Case.

The petitioners Robert G. Leslie and Marilyn B. Leslie (collectively referred to as "Leslie") were at all relevant times husband and wife and residents of Santa Paula, California. Leslie is the owner of R & H Paving Company and, consistent with his goal to be financially independent in retirement, he required that all of his investments generate a

positive cash flow. The cyclical nature of the construction business meant sporadic cash flow and these investments were intended to level the cash flow to a manageable degree. Leslie was therefore willing to invest in ventures which brought a considerable amount of risk, a situation not unlike Leslie's paving business which itself possessed significant risk.

To this end, Leslie in the 1970's invested in such enterprises as vacant land in Eureka, California; an Ar- kansas poultry farm; a cattle ranch in Oklahoma; and a restaurant, commercial property and apartment building in Rogers, Arkansas. In making most of these investments, Leslie relied upon his accountant/business advisor (Roy Tolson) or his business associate (Joe Rasey); but he personally reviewed the financing aspects of all these investments, making some of them outside of California for diversity and because of more favorable financing terms. Because Leslie's predominant motive with his investments was to generate a good cash flow, he declined to pursue any tax-advantaged investments in the 1970's which did not provide cash flow.

In 1980, Leslie engaged one Donald Short as his investment advisor. Short was a CPA and Leslie relied upon him to carry out his investment philosophy, i.e., sound but not riskless business investments which would generate a positive cash flow. Short investigated commodity trading, decided it met Leslie's investment criteria and eventually contacted F.G. Hunter & Associates ("Hunter ") through which Leslie's trades could be implemented in Hunter's gold futures spread program. He talked to Russell Klein from Hunter on three occasions, Leslie attended one of these meetings. The principal topic of these discus- sions was the profit potential from gold spread transac- tions – not tax benefits; and Leslie eventually decided to invest $175,000.00 initially in the gold spread trading program.

After Leslie made this decision, he and Short received a notebook containing several documents from Hunter, one of which was an Adcom Trading letter summarizing the profit potential for trading gold spreads. Leslie was particularly influenced by this document's emphasis on the profit potential from this kind of commodity trading. He also relied upon FAX, Inc., an investment advisor associated with Hunter, to make commodity trades.

In November of 1980, the gold market was extremely volatile and Hunter's Klein was repeatedly calling Leslie to establish a position so that he could maximize his profit from this volatility. On December 1, 1980, Leslie made his first investment in commodity trading in the amount of $178,500 to cover initial margin requirements and transaction costs. His first position in the gold futures market was a forward spread with a potential profit if interest rates or the price of gold declined.

On December 10, 1980, Leslie upon Klein's recommendation repositioned himself in the market in order to create a better opportunity to profit from those market movements; neither Leslie nor Short was aware of the tax consequences of this repositioning. Leslie's new positions reversed the earlier forward spread positions and established backward spread positions which had a profit (or loss) potential approximately three times his original positions. This repositioning, however, resulted in a loss of 1,511,489.40 from the cancellations of the original long contracts. Upon Klein's further recommendation, Leslie made another repositioning on December 30, 1980, resulting in a total gain of $198,450. 00 from the sale (or offset) of long and short contracts.

By February of 1981, however, Leslie had become dissatisfied with FAX, Inc.'s investment advice and successfully sought from Hunter a refund of the $35,000.00 management fee he had paid for this service. After fur-ther dissatisfaction with Hunter in early 1981, Leslie eventually retained Merrill Lynch for his commodity trading. Bill Kearney of Merrill Lynch recommended a number of investments; Leslie agreed to make an oil and gas invest- ment but rejected several others because they presented an opportunity for return on investment only through tax benefits. Throughout the rest of 1981 and 1982, Leslie continued his commodity trading activity through Merrill Lynch and he also began trading in bonds and stock options as well as in gold and silver futures contracts but not spreads. On May 26, 1982, Leslie liquidated his final positions with Hunter. In the end, Leslie lost approximately $58,310.00 in his trading of gold futures contracts through Hunter.

As Edward B. Horowitz, an experienced commodity trader later explained, the Hunter program of gold futures trading, like other such programs, includes a profit potential associated with spread transactions. A gold spread consists of a long position and a short position, with each position having a different delivery date and each of the two positions referred to as a "leg." Traders who invest utilizing spread positions hope to profit by a favorable change in the price relationship or the difference between their long and short positions. Since the price of gold futures contracts is a function of the interest cost of carrying this precious metal from one futures delivery month to another delivery month, the major forces affecting gold futures spreads are gold prices and short-term interest rates.

Horowitz further explained that Leslie's particular position in the gold futures market on December 1, 1980, had a

profit potential if interest rates (or gold prices) declined. The position he established on December 10, 1980, had three times more profit potential and was positioned to capitalize on an increase in interest rates or the price of gold in this volatile market. The position which he established on December 30, 1980, had a profit or loss potential almost two times greater than the December 10th position and was at a point where it could profit from an increase in interest rates or the price of gold. That the position Leslie established on December 30, 1980, experienced an actual loss of $58,600.00 based purely upon market movement for the period between then and No- vember 30, 1981, indicates a profit potential in that amou nt if he had taken the opposite positions. The unpredictability or volatility of the gold futures market carries with it such risk; but the profit potential was always present if gold prices or interest rates moved in the proper relationship to Leslie's spread positions.

In 1980, Leslie prepared his Federal income tax returns using the cash receipts and disbursements method of accounting and reported ordinary losses from his gold futures straddle transactions in the amount of $1,530,268 and short-term capital gains in the amount of $198,030. He also claimed as deductions $17,500 in fees paid to Hunter. In 1981, Leslie reported ordinary losses in the amount of $55,302 and long-term capital gains in the amount of $97,160. In 1982, he reported long-term capital gains from the Hunter transactions in the amount of $1,172,950.

On February 20, 1987, the respondent Commissioner of Internal Revenue Service ("the Commissioner") issued to Leslie a notice of deficiency, disallowing deductions of straddle losses totaling approximately 1.5 million for 1980, 1981, and 1982.

According to the Commissioner, Leslie's underpayment was attributable to "tax motivated transactions" instead of ones entered into for profit; and he was therefore liable for the underpayment of taxes pursuant to Section 6621(c) of the Internal Code (Title 26).

On August 30, 1993, the Commissioner filed a motion for order to show cause why Leslie's case was different than the case of *Ewing v. Commissioner*, 91 T.C. 396 (1988), *aff'd without published opinion*, 940 F.2d 1534 (9th Cir. 1991). In *Ewing*, the Tax Court determined that none of the ten petitioners there had engaged in the Hunter program of gold futures straddle transactions primarily for profit but rather did so in order to obtain favorable tax benefits. *Id.* at 418-421. As such, their straddle loss deductions in 1980 and 1981 were not allowable under Section 165(c)(2) of the Internal Revenue Code and Section 108 of the Deficit Reduction Act of 1984, as amended by the Tax Reform Act of 1986. *Id.* at 414; 420- 421. On October 18, 1993, Leslie responded to the Commissioner's motion by submitting that his primary motivation for engaging in gold futures transactions with Hunter was for profit and therefore was distinguishable from those taxpayers in *Ewing*.

With the matter in this posture, a two-day trial was held in the United States Tax Court in January of 1995 in order to determine, among other things, whether these transactions by Leslie in gold futures were entered into for profit (App. 22a-23a). On February 28, 1996, the Tax Court, Fay, J., issued its Memorandum Findings of Fact and Opinion. *Robert G. Leslie et al. v. Commissioner of Internal Revenue*, 71 T.C.M. (CCH) 2233 (2/28/96) (App. 21a-52a). It determined inter alia that Leslie's primary motivation in entering into the Hunter transactions was to generate tax benefits and not to realize profits. *Id.*

Invoking the jurisdiction of the United States Court of Appeals for the Ninth Circuit pursuant to 26 U.S.C. §7482, Leslie challenged this ruling as unsupported by the evidence adduced below and argued that the overwhelming proof demonstrated that his Hunter investments were not tax motivated. He also contended, among other things, that the Tax Court had abused its discretion by admitting into evidence the unqualified, unfounded, biased and ultimately unhelpful opinion testimony of Dr. Richard J. Teweles, a supposed expert offered by the Commissioner to show that his participation in the Hunter spread transactions in 1980, 1981 and 1982 could not have been motivated by profit.

In an opinion issued on May 27, 1998, the court of appeals affirmed the Tax Court's decision in all respects. It found that while the earlier decision in *Ewing* was not conclusive of Leslie's appeal, the appellate court nevertheless concluded that *Ewing's* reasoning was "highly relevant to Leslie's case and weighs in favor of affirming the Tax Court's decision" (App. 51). But even apart from *Ewing's* result, the court saw uncontroverted objective evidence which amply supported the conclusion below that Leslie's primary motive in participating in the "Hunter straddle" was to realize tax benefits (*Id.*) Specifically, it identified the Hunter programs' use of the alternative liquidation techniques of "cancellation" and "assignment" in lieu of the more traditional "offset" procedure to close out a contract as designed to provide maximum tax savings instead of profit (*Id.* at 5a-6a). That is, the "cancellation" technique was devised so that Hunter program participants could claim ordinary loss treatment rather than capital loss treatment; "assignment" was contrived so that Hunter investors could characterize straddle gains as long-term capital gains, instead of short-term capital gains (*Id.* at 6a).

Besides Leslie's use of these close-out procedures, the court of appeals pointed to Leslie's review of Hunter's promotional materials which focused on these liquidation procedures and which demonstrated with graphs the pre- and post-tax profit potential and tax savings that could be achieved through the Hunter program (*Id.* at 6a-7a). According to the court (and the Commissioner), Leslie followed the instructions he had read in the promotional materials for obtaining tax benefits through the cancellation of loss contracts and the assignment of gain contracts (*Id.* at 7a). The court of appeals then somehow extracted from Leslie's reply brief the admission that his use of these close-out procedures was "lawful" and the "candid" con- cession that it was motivated by his desire to minimize his tax liability (*Id.* at 7a-8a). Finally, the court relied upon the "potent evidence" that Leslie paid more in commissions and fees than he would have incurred had he liquidated his gold futures contracts in the usual way (*Id.* at 8a).

In conclusion, the court of appeals stated:

> We do not pretend that the evidence suggesting the primacy of a motivation other than profit is airtight. It is conceivable, we suppose, that [Leslie's] tax-savings motive, although significant, was no more significant than his profit motive. However, as an appellate court, we do not sit in de novo review of the Tax Court's decision regarding motivation. And it is certainly not *inconceivable* that [Leslie's] concern for tax savings did predominate, as the Tax Court found. Indeed, we conclude that, on balance, the evidence supports the Tax Court's determination. At any rate, its decision

> assuredly was not clearly erroneous, and we therefore decline to disturb it.

(*Id.* at 9a). In view of its disposition of Leslie's tax-law-based contentions, the court of appeals did not address the evidentiary issue of whether the Tax Court erred in ad mitting the report and testimony of the Commissioner's expert witness, Dr. Richard Teweles (App. 3a;19a).

The decision of the court of appeals was issued on May 27,1998 (App. 1a). Leslie then petitioned pursuant to Fed. R. App. P. 40(a) for reconsideration of the court of appeals' ruling (App. 53a). His petition contended that the court had failed to address those objective facts which support and verifies his subjective intent to make a profit with his commodities trading. In addition, Leslie took particular exception to the court's use of statements contained in his reply brief to extract admissions and concessions from him that his primary motivation in making gold futures trades was to secure tax benefits. As Leslie put it, it was egregiously unfair and a violation of the Due Process Clause for the court to infer unilaterally from his reply brief crucial, damaging concessions about his investment motivations, the key issue in this case, without giving him an opportunity to respond to this critical inference at a meaningful time and in a meaningful manner.

Finally, Leslie argued that the Tax Court could not possibly have found that his gold futures trading was tax motivated instead of motivated by profit without implicitly relying upon Teweles' opinion testimony, proof which should have been rejected out of hand because this witness lacked any qualifications, his testimony was without foundation, biased and ultimately unhelpful to the factfinder.

On July 30,1998, the court of appeals denied Leslie's petition for rehearing (App. 53a). Leslie has duly filed this petition of writ of certiorari within ninety days of the entry of this latter ruling. *Communist Party of Indiana v. Whitcomb*, 414 U.S. 441, 445-446 (1974). *FTC v. Colgate-Palmolive Co.*, 380 U.S. 374, 384 (1965). *United States v. Healey*, 376 U.S. 75, 77-78, 80 (1964).

Reasons for Granting the Writ.

1. **The Decision Below Misapplies And Emasculates The Decisions of This Court Which Define The Factfinding Function of The Trial Court And The Standard For Reviewing Those Findings Set Out in Fed.R.Civ. P.52(a).**

In *Interstate Circuit v. U.S.*, 304 U.S. 55, 56-57 (1938), this Court clearly established the mandatory duty of a trial judge (under then Equity Rule 70½) trying a civil matter without a jury to find the facts specially and to state separately his conclusions of law thereon. *Id.* Subsequent decisions by this Court in *Kelley v. Everglades District*, 319 U.S. 415, 420-422 (1943) and *Commissioner v. Duberstein*, 363 U.S. 278,292-293 (1960) further reinforced the affirmative and obligatory nature of Rule 52(a) 's language.

The purposes of Rule 52(a)'s requirement in a non-jury case are (1) to aid the appellate court by affording it a clear understanding of the basis for the trial court's decision; (2) to make definite just what the civil action decided for purposes of applying *res judicata* and estoppel principles in subsequent actions; and (3) to evoke care on the part of the trial judge in ascertaining the facts. *Featherstone v. Barash*, 345 F.2d 246, 249-251 (10th Cir. 1965). A trial judge who has formulated and articulated his findings of fact and

conclusions of law as part of his decisionmaking process has thus
satisfied himself that he has dealt fully and properly with all of the issues in the case *before* he decides it. In the absence of such a process, there is no certainty that a full and fair consideration of all the evidence and issues has been provided by the nisi prius court. Moreover, without adequate findings or conclusions the reviewing tribunal is unable to determine whether the decision reached by the lower court follows as a matter of law from all the evidence adduced and whether any of the "facts" relied upon by the trial judge in making a decision have any substantial support in the evidence.

The requirement of Rule 52(a) of express findings and separately stated conclusions is "thus far from a tech- nicality [but] [o]n the contrary, it is to insure against Star Chamber methods, to make certain that justice shall be ascertained accordingly to facts and law. . . ." *Saginaw Broadcasting Co. v. Federal Communications Commission*, 68 App. D.C. 282,286; 96 F.2d 554,559 (1938). For this reason, these provisions of Rule 52(a) cannot be waived and any agreement between the parties that the trial judge need not enter findings of fact or conclusions of law is therefore ineffective. *In re G.W. Giannini, Inc.*, 90 F.2d 445,447-448 (2d Cir. 1937). *United States v. One Assortment of 25 Firearms*, 483 F.Supp.16,18-19 (E.D. Tenn.1980). *See In re Scrap Disposal, Inc.*, 8 B.C.D.504, 505; 15 B.R. 296,297 (9th Cir. Bankruptcy App. 1981).

Rule 52(a) imposes a corresponding duty on the appellate tribunal when reviewing such findings. As interpreted by this Court, the reviewing body is encouraged by the rule to examine the entire record because it states that a trial court's "finding is 'clearly erroneous' when although there is evidence to support it, the reviewing court on the entire

evidence is left with the definite and firm conviction that a mistake has been committed." *Bose Corp. v. Consumers Union of U.S. Inc.*, 466 U.S. 485, 499 (1984) quoting *United States v. United States Gypsum Co.*, 333 U.S. 364, 395 (1948) (emphasis in original). See *Concrete Pipe & Products of Cal. Inc. v. Construction Laborers Pension Trust for Southern Cal.*, 508 U.S. 602, 622-623 (1993); *Salve Regina College v. Russell*, 499 U.S. 225, 233 (1991). Even where a lower court's findings of fact depend on the credibility of a witness, a reviewing tribunal may still find a clear error if documentary or objective evidence contradicts the witness' story; or the story itself may be so internally inconsistent or implausible on its face that a reasonable factfinder would not credit it. *Anderson v. Bessemer City*, 470 U.S. 564,575 (1985).

A *fortiori* an appellate court under Rule 52(a) must regard a finding of fact as clearly erroneous and therefore must set it aside when there is either inadequate or no evidentiary support in the record to warrant such a find ing. *Coalition to Save our Children v. Bd. of Educ.*, 90 F.3d 752, 759 (3rd. Cir. 1996). *Zimmerman v. Sloss Equipment, Inc.* 72 F.3d 822,825(10th Cir. 1995). *Duty v. United States*, 735 F.2d 1012, 1015 (6th Cir. 1984). *Cannizzo v. Farrell Lines, Inc.*, 579 F.2d 682, 686 (2nd Cir. 1978).

Instead of engaging here in a genuine, independent appraisal of the evidence before it showing Leslie's overall investment strategy and his subjective intent consistent with that strategy in trading in gold futures within the Hunter program, the Tax Court chose to adopt wholesale all of the central findings in *Ewing v. Commissioner*, 91 T.C. 396, *aff'd without published opinion*, 940 F.2d 1534 (9th Cir. 1991), the "test case for the F.G. Hunter transactions," see *Nolte v. Commissioner*, 69 T.C.M. 1828, 1829 (1995), to conclude that Leslie's participation therein was primarily for tax

benefits. That is, the trial court's findings focused not on Leslie's articulated intent in pursuing this particular investment opportunity but rather relied upon the investment opportunity itself as defined by its prior decision in *Ewing* involving different facts and different investors to conclude that his primary motivation was to secure tax benefits instead of profit.

In its attempt to impress upon this case the logic and result of *Ewing*, the Tax Court violated its fundamental duty under Rule 52(a) to find facts which were supported by the evidence. Specifically, the trial court wrongly found that Leslie did not have a profit motive when he began his participation in the Hunter program (App. 34a). Yet it was uncontradicted that Leslie made the decision to invest $178,500 with Hunter before he understood or appreciated Hunter's trading techniques, how commodities sprea ds were established or what tax benefits could be obtained from Hunter trading losses. The Tax Court simply chose to ignore the evidence that Leslie, even at the time of trial, did not appreciate the difference between ordinary and capital losses, long and short-term capital gain or even how the closeout procedures actually worked.

Secondly, the record explicitly states that although Leslie "ultimately" read the Hunter material "as part of his decision" to pay Hunter, Leslie had already decided to invest before receiving the Hunter material and before meeting with and learning from Hunter's Klein about any potential tax advantages. Furthermore, the evidence show ed without contradiction that Leslie's decision to invest was profoundly impacted by his historic quest for substantial profits, the letter from Adcom Trading, Inc. as well as various substantive articles regarding commodities trading together with Klein's oral advice to take more aggressive, profit-minded positions in the volatile commodities mar- ket. *Nowhere does the evidence*

reflect any basis for the Tax Court's conclusion that Klein recommended modifying Leslie's position strictly to "realize substantial tax losses. . . ." Thus while Leslie may have realized some tax benefits with his closeout procedures, he stood to gain much more taxable profit in the future as a result of these transactions. See *Stoller v. Commissioner*, T.C. Memo. 1990-659; *rev'd on other grounds*, 994, F.2d 855 (D.C. Cir. 1993). Leslie's proof therefore showed a *bona fide* profit motivation on his part for entering into the Hunter transactions; any tax benefits incident thereto were a welcome by-product, not an instigating force.

Thirdly, the Tax Court is in clear error in finding that"

> [Leslie] decided to make his investment with Hunter in December 1980 based on the information Short obtained from his meetings and conversations with Klein and due to repeated calls from Klein urging him to make an investment with Hunter immediately. *Klein's reason for wanting petitioner to invest at the time was that the volatility of the gold market presented an opportunity for immediate tax benefits.*

(App. 34a). The trial testimony showed without any con- tradiction that Klein called so that Leslie could "take advantage of the volatile market movement;" any tax implications were only incidental to the profit that could have been made in the market and the 25-50 percent profit which Leslie expected to make. In this way, the Tax Court has wrongly amended the evidence and confected findings in order to make Leslie's case come within *Ewing's* holding. The guidelines identified in *Fox v. Commissioner*, 82 T.C. 1001(1984) for determining motivation do not provide the Tax Court

with the power to ignore unimpeached, credible evidence simply because it comes from the taxpayer.

Finally, the Tax Court chose to rely implicitly on the opinion of Dr. Richard Teweles, the same "expert" who testified on behalf of the Commissioner in *Ewing*, to but tress its finding that Leslie's investments were motivated by a desire to secure tax benefits rather than a profit. But any finding of fact based upon Teweles' testimony was clear error because his opinion evidence was unqualified, unfounded, biased and ultimately unhelpful to the fact finder. The primary shortcoming of this testimony is that it is unsupported by any evidence. Nothing in Teweles' report substantiates the Commissioner's claim that Leslie's use of cancellation and assignment violated any statute, rule or commodities procedure. Moreover, Teweles agreed with Leslie's own expert (Horowitz) that the Hunter positions established by Leslie proved a profit potential. Under cross-examination, Teweles further admitted that Leslie's profit of $58,000.00 was profit, just not enou gh of a profit for him to acknowledge.

For these reasons, it was wrong for the Tax Court to import into these proceedings the holding embodied in *Ewing*, its "test case" for Hunter transactions, in order to assign to Leslie an intent to obtain tax benefits rather than to profit by participating in those transactions. Rule 52(a) imposed upon that court a positive duty to appraise independently the evidence and formulate findings based thereon. The Tax Court failed to perform that duty and failed to assess in any intelligent or coherent way Leslie's subjective motivation in making the investments that he did.

The court of appeals compounded the error of the Tax Court by failing to measure the findings of fact against the "clearly erroneous" standard embodied in Rule 52(a). If it

had done so irrespective of the *Ewing* decision, the court of appeals would have been compelled to conclude that the Tax Court committed plain error on this record in finding that Leslie had invested in the Hunter program for the purpose of obtaining tax benefits rather than realizing profit.

In this regard, it is noteworthy that the court of appeals' decision adopts without adequate citation the Tax Court's decision in *Fox v. Commissioner*, *supra*. (App. 9a). The citation is incomplete because the appellate court never separates itself from the *Ewing* decision, one which cites *Fox* liberally throughout its text. In addition, not only is Teweles repeating here the testimony which he proffered in *Ewing*, he even refers in his testimony to Leslie as "Leavitt," one of the investors in *Ewing* (R.App. 341- 342).

In short, neither the Tax Court nor the court of appeals ever considered the evidence in this case independent of the rationale or result in *Ewing*, the "test case" on the Hunter gold futures transactions. There was no independent analysis of Leslie's subjective intent or motivation in entering into the Hunter gold futures program, only a knee-jerk reaction to "a test case" decided in 1988. None of the proof in *Ewing* addressed Leslie's investment motivation; nor does that case speak for all time to every circumstance surrounding every investor who opted to participate in the Hunter program. Leslie's proof is unique; the circumstances of his investment were unique and he deserved to have that question decided fairly, impartially and apart from the conclusory force of a 1988 "test case" to which he was not a party.

In view of the Ninth Circuit's historical disdain for appellate factfinding, *Lundgren v. Freeman*, 307 F.2d 104,113-114 (9th Cir. 1962); *Panaview Door & Window Co. v. Reynolds Metals Co.*, 255 F.2d 920,922-923 (9th Cir. 1958),

it was error to adopt the Tax Court's reasoning and thereby import into these proceedings *Ewing's* findings in order to control the most crucial fact question in this case.

Imposing upon Leslie the force of the *Ewing* decision through the contrivance of "admissions" and "concessions" in his appellate brief in order to fill perceived gaps in the evidence adduced below presents further problems of constitutional proportions. "[F]airness can rarely be obtained by secret, one-sided determination of facts decisive of rights .... [A]nd no better instrument has been devised for arriving at truth than to give a person in jeopardy of serious loss notice of the case against him and opportunity to meet it." *Connecticut v. Doehr*, 501 U.S. 1.14 (1991) quoting *Joint Anti-Fascist Refugee Comm. v. McGrath*, 341 U.S. 123,170-172 (1951) (Frankfurter, J., concurring). If the court of appeals wishes to extract crucial evidentiary admissions from Leslie, it should do so by providing him with fair notice of same and then by allowing him to be heard at a meaningful time and in a mean- ingful manner. *Matthews v. Eldridge*, 424 U.S. 319,333 (1976). *Goldberg v. Kelly*, 397 U.S. 254, 267(1970) and case cited. Absent these safeguards, none of which were provided Leslie, the court of appeals' reliance upon such alleged admissions or concessions must be utterly disregarded.

2. The Reliance by the Courts Below on Alleged Expert Opinion Addressing the Most Crucial Issue in this Case, i.e., Leslie's Investment Motivation, Conflicts with this Court's Decisions Setting Forth the Re- quirements For the Admission of Such Evidence.

In *Daubert v. Merrell Dow Pharmaceuticals, Inc.*, 509 U.S. 579, 590-593 (1993), this Court adopted a new standard for the admissibility of scientific evidence based upon the Federal Rules of Evidence. It found that Rule 702 clearly anticipated some "gatekeeping" function for the trial judge in order to keep "junk science" out of the courtroom:

> {i]n order to qualify as "scientific knowledge," an inference or assertion must be derived by the scientific method. Proposed testimony must be supported by appropriate validation --i.e., "good grounds," based on what is known. In short, the requirement that an expert's testimony pertain to "scientific knowledge" establishes a standard of evidentiary reliability.

509 U.S. at 590.

In the wake of *Daubert*, courts of appeals have read it as requiring a two-step inquiry: (1) does the expert's testimony pertain to scientific knowledge, i.e., does it relate to known facts or ideas which are grounded in the methods and procedures of science or is it merely subjective belief or unsupported speculation?; and (2) will the testimony assist the factfinder in determining a fact in issue? 509 U.S. at 590-591. See e.g., *Berry v. City of Detroit*, 25 F.3d 1342, 1349-1350 (6th Cir. 1994); *O'Connor v. Commonwealth Edison Co.*, 13 F.3d 1090, 11006 (7th Cir. 1994).

If Teweles' testimony concerning the nature, extent and characteristics of Leslies' gold futures commodities trading in the Hunter program can be termed "scientific evidence" within *Daubert*, see *Berry v. City of Detroit*, 25 F.3d at 1349-1350; *Laureys v. Commissioner*, 92 T.C. 101,126-129 (1989), it went well beyond the expertise of this particular witness and should have been authorita tively rejected out of hand by the Tax Court as well as by the court of appeals as it could not possibly have assisted the factfinder to determine any genuine fact issue. Under *Daubert*, if the trial judge is not persuaded that a so-called expert has genuine knowledge that can be genuinely helpful to the factfinder, he should not let him testify. 509 U.S. at 594-595. *Wilson v. City of Chicago*, 6 F.3d 1233, 1238-1239 (7th Cir. 1993).

Here Teweles was never an employee of the Commodities Futures Trading Commission ("CFTC") and yet a major portion of his testimony was devoted to CFTC procedures, rules and regulations. In the one CFTC opinion which cites Teweles' testimony, the judge found that Teweles' "position in arbitration cases is contrary to Com- mission precedent." The only Tax Court case in which Teweles' testimony is cited was *Michelson v. Commissioner*, T.C. Memo 1990-27. In that case, the Tax Court disregarded Teweles' testimony based on his lack of understanding of the facts with regard to CFTC matters. *Id.* Moreover in *Reed v. Sage Group. Inc.*, C.F.C.T. Docket No. 85-R312 (1986) Teweles' opinions on CFTC's procedures were disregarded and found to be in contradiction to actual CFTC procedures. *Id.* 1986 West Law 65815, p.4 (C.F.T.C.). Finally, Teweles was banned from trading securities by the National Association of Securities Dealers by having his securities license revoked for sixteen (16) years, making his testimony regarding trading regul ations questionable at best.

Teweles' opinion testimony concerning tax conse quences, tax motivation and other tax issues surrounding Leslie's trading is similarly suspect. Teweles has never taught university level tax classes, does not possess a grad- uate degree in taxes, has never authored tax opinion letters and does not prepare tax returns. Yet he was allowed to cast an opinion that all of Leslie's gold futures trading within the Hunter program was motivated by tax benefits rather than by profit, an opinion which is contrary to Leslie's investment history (before and after Hunter) as well as to the demonstrated fact that Leslie did not have a capable enough understanding of tax and trading issues to have consciously formulated any motive to invest other than for profit.

Finally, Teweles had testified for the Commissioner earlier in *Ewing* and had already made his mind up about the nature of the Hunter gold futures program and any investor who participated in it. As such, he clearly was a zealous advocate for the Commissioner's position here and lacked any of the objectivity needed to produce reliable testimony useful to the factfinder. See *Perry v. United States*, 755 F.2d 888, 890 (11th Cir. 1985); *Laureys v. Commissioner*, 92 T.C. at 129.

All of these considerations surrounding Teweles' opinion testimony, whether characterized as scientific knowledge or not (see *Berry v. City of Detroit*, 25 F.3d at 1350-1351), rightly invoked the trial court's "gatekeep ing" function recognized by this Court in *Daubert* "to insure that any and all...testimony or evidence admitted is not only relevant, but reliable." 509 U.S. at 589. Because it was neither, Teweles' testimony should have supplied no foundation for the inference that Leslie's trading was motivated by tax benefits rather than by profit.

Conclusion.

For all of these reasons, a writ of certiorari should issue to review the opinion of the United States Court of Appeals for the Ninth Circuit and, ultimately, to vacate the judgment and remand the cause to the Tax Court for the entry of a new judgment in Leslie's favor.

Respectfully submitted,

Dennis P. Derrick
Counsel of Record
Seven Winthrop Street
Essex, Ma 01929
(978) 768-6610

Kevin M. McGuire
Law Office of Federico
Castelan Sayre
450 Newport Center Drive
Suite 650
Newport Beach, Ca 92660
(949) 721-0221

(Footnotes trail opinion)

146 F.3d 643
81 A.F.T.R.2d 98-2153, 98-2 USTC P 50,494, 98 Daily Journal D.A.R. 5505
(Cite as: 146 F.3d 643)

Robert G. LESLIE and Marilyn B. Leslie, Petitioners-Appellants,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent-Appellee.

No. 96-70880.

United States Court of Appeals, Ninth Circuit.

Argued and Submitted Dec. 2, 1997.

Decided May 27, 1998.

Taxpayers appealed denial of deductions for losses resulting from gold- futures "straddle" transactions. The United States Tax Court, William M. Fay, J., 1996 WL 83310, denied relief and imposed enhanced-interest penalty. Taxpayers appealed. The Court of Appeals, O'Scannlain, Circuit Judge, held that: (1) Tax Court's conclusion that taxpayer's primary motive in participating in straddle was to realize tax benefits, rather than profits, was supported by sufficient evidence; (2) tax-motivated straddle losses may offset straddle gains, thus reducing investor's tax liability, but net loss resulting from straddle transactions may not be deducted against other income; (3) taxpayers were not entitled to deduct commissions paid for tax-motivated straddle transactions; and (4) taxpayers were properly assessed increased interest for substantial

underpayment attributable to tax-motivated straddle transactions.
Affirmed.

Kevin M. McGuire, Law Offices of Federico Castelan Sayre, Newport Beach, California, for petitioners/appellants.

Laurie Snyder, United States Department of Justice, Tax Division, Washington, DC, for respondent/appellee.

Appeal from the United States Tax Court; William M. Fay, Judge, Presiding. T.C. No. 9814-87.

Before: FERGUSON, THOMPSON, and O'SCANNLAIN, Circuit Judges.

O'SCANNLAIN, Circuit Judge:

We examine the lingering federal income tax consequences of participation in gold-futures "straddle" transactions in the early 1980's, when the top tax-rate bracket was 70%.

I

On their 1980, 1981, and 1982 federal income tax returns, Robert and Marilyn Leslie claimed gains and losses resulting from gold-futures "straddle" transactions that Robert entered into with futures commission merchant F.G. Hunter & Associates ("Hunter"). A futures contract, in a nutshell, is an agreement either to buy or to sell a specific quantity of a specific commodity during a designated month in the future. A contract--called a "position"--is "long" if it requires its holder to purchase the commodity, and "short" if it mandates a sale. For purposes relevant to this case, a "straddle" occurs when a single individual (in this instance, Robert) holds both (1) a long position requiring delivery in one month and (2) a short position in the same commodity requiring delivery in a

different month. Each of the two positions constitutes a "leg" of the overall straddle transaction. A straddle leg is generally "closed out" by acquiring an offsetting position. See Miller v. Commissioner, 836 F.2d 1274, 1276 (10th Cir.1988) . [FN1]

In 1980, the Leslies reported ordinary losses from Robert's straddle transactions in the amount of $1,530,268 and short term capital gains in the amount of $198,030. They also claimed as deductions $17,500 in fees paid to Hunter. In 1981, the Leslies reported ordinary losses in the amount of $55,302 and long term capital gains in the amount of $97,160. And in 1982, they reported long term capital gains from Hunter transactions in the amount of $1,172,950.
On February 20, 1987, the Commissioner of the Internal Revenue Service ("the Commissioner") issued to the Leslies a Notice of Deficiency, disallowing deductions of straddle losses totalling approximately $1.5 million for 1980, 1981, and 1982. A two-day trial was held in Los Angeles in early 1995. Finding that Robert's primary motivation in entering into the Hunter straddle transactions was to generate tax benefits, and not to realize profits, the Tax Court concluded that the losses incurred on the straddle transactions were not deductible. The court also rejected the Leslies' claim that they were entitled to a "net loss" deduction for 1982 in the amount that their straddle losses exceeded their straddle gains, denied their claimed deduction of fees paid to Hunter in setting up their straddle transactions, and imposed an enhanced- interest penalty of 120% of the rate otherwise payable on their tax underpayments.

The Leslies appealed, challenging each of the Tax Court's several conclusions. We have jurisdiction pursuant to 26 U.S.C. § 7482. We address of the Leslies' contentions in turn. [FN2]

II

[1] The central issue in this appeal is whether the Leslies are entitled to deduct losses on Robert's Hunter investments, as claimed on their 1980, 1981, and 1982 tax returns. The Deficit Reduction Act of 1984 ("DEFRA") permits the deduction of a loss sustained through participation in a pre-1982 tax straddle only "if such loss is incurred in a trade or business, or if such loss is incurred in a transaction entered into for profit though not connected with a trade or business." DEFRA § 108(a), Pub.L. No. 98-369, 98 Stat. 494, as amended retroactively by § 1808(d) of the Tax Reform Act of 1986, Pub.L. No. 99-514, 100 Stat. 2817 (emphasis added). [FN3] The Leslies have not alleged that Robert incurred his losses in the course of a trade or business. Consequently, we must focus our attention on the question whether Robert's motives for entering into the tax straddle transactions sponsored by Hunter were aimed at generating profit (which would render the losses deductible), or instead were aimed at saving taxes (which would render them nondeductible). The Commissioner's initial determination that Robert's primary motivation was to secure tax savings is presumptively correct, see Welch v. Helvering, 290 U.S. 111, 115, 54 S.Ct. 8, 78 L.Ed. 212 (1933) , and the burden of proving profit-motive is on the taxpayer, see Wolf v. Commissioner, 4 F.3d 709, 713 (9th Cir.1993) . The Tax Court agreed with the Commissioner and concluded that Robert's "motives in entering into these transactions, despite [the Leslies'] arguments to the contrary, were primarily to obtain substantial tax benefits." Leslie v. Commissioner, 71 T.C.M. (CCH) 2233, 2242 (1996) .

[2] The Tax Court's determination that Leslie entered into the tax straddle at issue for tax savings rather than for profit is a finding of fact, and is therefore reviewable only for clear error. See Independent Elec. Supply, Inc. v. Commissioner, 781 F.2d 724, 727 (9th Cir.1986) . Consequently, we must

uphold the Tax Court's conclusion unless we are "left with the definite and firm conviction that a mistake has been committed." United States v. United States Gypsum Co., 333 U.S. 364, 395, 68 S.Ct. 525, 92 L.Ed. 746 (1948) . In other words, if the Tax Court's account of the evidence is "plausible in light of the record viewed in its entirety, [we] may not reverse it even though convinced that had [we] been sitting as the trier of fact, [we] would have weighed the evidence differently." Wolf, 4 F.3d at 712-13 (quoting Service Employees Int'l Union v. Fair Political Practices Comm'n, 955 F.2d 1312, 1317 n. 7 (9th Cir.1992) (quoting Anderson v. City of Bessemer City, 470 U.S. 564, 105 S.Ct. 1504, 84 L.Ed.2d 518 (1985))).

In Ewing v. Commissioner, 91 T.C. 396, 1988 WL 89128 (1988) , aff'd without opinion, 940 F.2d 1534 (9th Cir.1991) , the Tax Court considered precisely the same Hunter straddle scheme at issue in this case, and concluded that the investors involved there were motivated by tax savings and not by profit. See id. at 420. We, of course, recognize that the Ewing decision is not conclusive of the Leslies' appeal; the motivation inquiry is an individualized one, dependent upon the particular taxpayer's state of mind. It cannot be doubted, however, that Ewing --called "the test case for the F.G. Hunter transactions," Nolte v. Commissioner, 69 T.C.M. (CCH) 1828, 1829 (1995) , aff'd without opinion, 99 F.3d 1146 (9th Cir.1996) --is highly relevant to the Leslies' case, and weighs in favor of affirming the Tax Court's decision.
[3] Even aside from Ewing, uncontroverted objective evidence amply supports the Tax Court's conclusion that Robert's primary motive in participating in the Hunter straddle was to realize tax benefits. As the Tax Court pointed out, what sets the Hunter program apart from other straddle investment opportunities is its use of the alternative liquidation techniques of "cancellation" and "assignment" in place of the

more traditional "offset" procedure. The unique close-out methods were designed to provide maximum tax savings in closing straddle contracts:
Specifically, the "cancellation" technique was devised so that its proponents could claim ordinary loss treatment rather than capital loss treatment. The "assignment" procedure was contrived so that Hunter investors could characterize straddle gains as long-term capital gains instead of short-term capital gains.

Id. at 2242. The promotional material distributed to prospective clients--which Robert stipulated he read--emphasized the tax advantages of the Hunter program, focusing specifically on the alternative liquidation procedures. For instance, one portion of the "Questions and Answers" section of the promotional materials provided:
3. Can I lose my investment?
Yes. As with any investment, the risk of loss is commensurate with the opportunities for profit. However, the opportunity for profit can be considerably enhanced, and the risk of loss substantially reduced by the proper choice of alternative methods of liquidating your contracts.

* * * * * *

8. How can the probability of gain be increased by choice of liquidation methods?
Income tax treatment of your gains or losses on each contract will be different depending upon the way your contract is closed out. There are ways to close out a contract in which you have a gain so that it will be taxed as a long term capital gain. For the contract in which you have a loss, you may liquidate so as to have ordinary loss. Depending upon your tax bracket, your risk of after tax loss on both these contracts will be very substantially reduced and will quite possibly be

converted into an after tax gain. Any net pre-tax profit will be significantly increased.

The promotional literature read by Leslie also included a series of graphs demonstrating pre- and post-tax profit potential for Hunter straddle investments and provided a worksheet designed for calculating "Tax Savings" achieved through the Hunter program. In addition, prior to investing, Leslie received and reviewed a 24-page opinion letter "concerning the federal income tax consequences" of the straddle contracts and a document entitled "Summary of Federal Income Tax Consequences." Both the letter and the summary detailed the various close-out options provided by the Hunter straddle program and the income tax consequences of each of the options.

Robert didn't just read about the alternative liquidation options, however. He apparently put them to work. As pointed out by the Commissioner in his brief, Robert "followed to a tee the instructions he had read in the promotional materials for obtaining tax benefits through cancellation of loss contracts and assignment of gain contracts." Indeed, Robert admitted in his reply brief to using the cancellation and assignment procedures, and argued there only that the techniques are "lawful." Whether or not they are legal, however, is not the pertinent issue; rather, the issue is whether Robert's investment decisions were profit-driven or tax-driven. And on that score, Robert seemed candidly to concede that his use of the close-out procedures was motivated by his desire to minimize his tax liability:

It is axiomatic that a taxpayer has the right to arrange his affairs in such a manner as to minimize his tax liability to the fullest extent possible.... Leslie (as a taxpayer) has every right under law to make economically bona fide arrangements to

reduce the amount of tax he owes. In the instant case, Leslie lawfully and appropriately reduced his taxes by engaging in legitimate economic transactions (i.e. cancellation and assignment of gold futures contracts) during the close out phase of his Hunter contracts.
Appellants' Reply Brief at 5.

In determining whether Robert's utilization of the cancellation and assignment close-out procedures indicates a tax-savings motivation, we think it significant, as did the Tax Court, that he "paid more in commissions and fees than he would have incurred had he liquidated his futures contracts in the usual way." Leslie, 71 T.C.M. (CCH) at 2242. For instance, the Tax Court noted, Robert was charged $15,520.14 for cancelling 175 gold futures contracts in December 1980, whereas his bill for offsetting those same contracts would have come to only $1750.00. See id.; see also Ewing, 91 T.C. at 408 (noting Hunter's fees for different close-out techniques). In fact, the Leslies' own expert admitted at trial that Hunter's commissions for the alternative liquidation techniques were "double" those charged for a traditional closeout. The increased commissions, however, bore their own rewards. In return for these increased fees, the Tax Court found, the Leslies would obtain ordinary loss deductions in the amount of $1.5 million for 1980. See Leslie, 71 T.C.M. (CCH) at 2242. We doubt that Robert's willingness to pay a premium for Hunter's special close-out procedures-- procedures that led to substantial tax savings--was coincidental; rather, like the Tax Court, we are persuaded that it is potent evidence that Robert's motivation in entering the transactions was something other than turning a profit.

The Leslies maintained that the Tax Court "ignore[d]" evidence tending to show that Robert's motive in entering into the Hunter straddle investments was profit. They pointed

first to Robert's own trial testimony, in which he suggested that he "had no clue what the difference was between ordinary and capital losses, long and short term capital gain or even how the Close Out Procedures actually worked." They also pointed to Robert's claim at trial that although he read the promotional material before "ultimately" investing, he had essentially already made up his mind prior to reading the literature. Finally, they pointed to Robert's investment history, which, they contended, demonstrates his "historic quest for substantial profits." As the Fox and Ewing cases teach, and as the Tax Court specifically observed, however, "greater weight is to be given objective facts than to self-serving statements characterizing intent." Id. at 2241 (quoting Ewing, 91 T.C. at 418).

We do not pretend that the evidence suggesting the primacy of a motivation other than profit is airtight. It is conceivable, we suppose, that Robert's tax-savings motive, although significant, was no more significant than his profit motive. However, as an appellate court, we do not sit in de novo review of the Tax Court's decision regarding motivation. And it is certainly not inconceivable that Robert's concern for tax savings did predominate, as the Tax Court found. Indeed, we conclude that, on balance, the evidence supports the Tax Court's determination. At any rate, its decision assuredly was not clearly erroneous, and we therefore decline to disturb it.

III

[4] The Leslies also claimed that, even assuming that Robert's motivation was not profit-oriented, they are entitled to a "net loss" deduction on their 1982 return insofar as Robert's losses sustained in 1980 from straddle transactions exceeded his straddle gains earned in 1981 and 1982. Section 108(c) of DEFRA provides that, even if a loss from a straddle transaction is not allowed as a deduction under § 108(a) because the underlying transaction is deemed to have been entered

into for tax savings and not for profit, "such loss shall be allowed in determining the gain or loss from dispositions of other positions in the straddle to the extent required to accurately reflect the taxpayer's net gain or loss from all positions in such straddle." DEFRA § 108(c). Emphasizing the language "net gain or loss," the Leslies argued that it is "quite clear" from the face of the statute that the net loss from a straddle transaction is properly deductible. Invoking the applicable Treasury Regulation, 26 C.F.R. § 1.165-13T, and Nolte v. Commissioner, 69 T.C.M. (CCH) 1828 (1995) , aff'd without opinion, 99 F.3d 1146 (9th Cir.1996) , however, the Tax Court rejected the Leslies' interpretation, and held that they may use the losses only to offset straddle gains and may not deduct a "net loss" from other income. The Tax Court's interpretation of § 108(c), like the interpretation of any statute, is reviewable de novo. See Parravano v. Babbitt, 70 F.3d 539, 543 (9th Cir.1995) .

[5] Although § 108(c) does mention the phrase "net loss," it nowhere explicitly states that such net loss shall be deductible; indeed, it never prescribes what should be done in the event a net loss is sustained. However, the applicable Treasury Regulation, relevant cases, and canons of statutory interpretation all counsel against the construction of § 108(c) the Leslies proffer, and in favor of the Commissioner's reading: Tax-motivated straddle losses may offset straddle gains, thus reducing an investor's tax liability, but a net loss resulting from straddle transactions may not be deducted against other income. The relevant Treasury Regulation, which "concern[s] the treatment of losses on certain straddle transactions," provides:

Q-3. If a loss is disallowed in a taxable year (year 1) because the transaction was not entered into for profit, is the entire gain from the straddle occurring in a later taxable year taxed?

A-3. No. Under section 108(c) of the Act the taxpayer is allowed to offset the gain in the subsequent taxable year by the amount of loss (including expenses) disallowed in year 1. 26 C.F.R. § 1.165-13T (emphasis added). The regulation's explicit and exclusive reference to "offset[ting] the gain" certainly suggests that the losses may be used by the taxpayer to reduce his taxable gain, but may not be used to create a net loss (i.e., over and above straddle gain) that is deductible against his gross income. In other words, up to and including the break-even point, tax-motivated straddle losses are subtracted from straddle gains and the difference is taxed. However, past the break-even point--where the taxpayer is sustaining a net loss--nothing happens; obviously, there is no taxable gain, but neither is there any positive loss to be deducted against other income. The Leslies cite The Ann Jackson Family Foundation v. Commissioner, 15 F.3d 917 (9th Cir.1994) , for the proposition that interpretive regulations should not be followed if they "fail to implement the Congressional mandate in a reasonable manner." It is far from obvious, however, that the "Congressional mandate" of § 108(c) is what the Leslies claim it is. The language of the statute is not altogether clear regarding the tax consequences of a straddle transaction net loss; consequently, it was not inappropriate for the Tax Court to look to the Treasury Regulation for interpretive guidance.

The correctness of the Tax Court's interpretation is further confirmed by two recent cases, both of which involve the very Hunter straddle scheme at issue in this case. In Nolte, the court held that it was "clear that petitioners are only entitled to offset their gains by the amount of the losses," and "are not entitled to an additional deduction for their 'net' losses in excess of their straddle gains." Nolte, 69 T.C.M. (CCH) at 1834. Likewise, in Ewing, the Tax Court cited the above-referenced Treasury Regulation and held that under §

108(c), the petitioners were "entitled to offset their gains ... by any losses that are not allowable ... under section 108(a)." Ewing, 91 T.C. at 421 (emphasis added).

The Tax Court's construction of § 108(c) finds additional support in comparable provisions of the Internal Revenue Code that losses resulting from transactions not entered into for profit are not deductible, see 26 U.S.C. § 165(a)-(c) ("There shall be allowed as a deduction any loss sustained during the taxable year and not compensated for by insurance or otherwise.... Th[at] deduction ... shall be limited to ... losses incurred in any transaction entered into for profit."); DEFRA § 108(a) (generally limiting deductions to those losses, if not incurred in a trade or business, "incurred in a transaction entered into for profit").

Finally, respect for statutory structure dictates that the Commissioner's interpretation of § 108(c) must be the correct one. Under the Leslies' construction, so long as an investor could muster a single dollar--or even a single penny--in tax-motivated straddle gains in a given year, he could deduct from his gross income in that year the "net loss" on his straddle transactions considered as a unit, no matter how large the loss. In other words, a substantial loss deemed nondeductible could--by virtue of a minimal gain-- become deductible. Obviously, such an interpretation flies in the face of § 108(a)'s categorical prohibition on deductions of losses for tax-motivated straddle transactions; § 108(c)'s exception would swallow § 108(a)'s rule (at least all but a penny's worth of it), rendering § 108(a) a virtual nullity. We decline to adopt such an awkward and a contextual reading of § 108(c). See United Savings Ass'n v. Timbers of Inwood Forest, 484 U.S. 365, 371, 108 S.Ct. 626, 98 L.Ed.2d 740 (1988) ("Statutory construction ... is a holistic endeavor.").

In light of the foregoing, we conclude, as did the Tax Court, that the Leslies are not entitled under § 108(c) to deduct net losses sustained after closing both legs of their tax straddles in 1982.

IV

[6] The Leslies argued to the Tax Court that they should be able to deduct the commissions paid to Hunter because the fees were "incurred in connection with the purchase and sale of capital assets." In support of their position, the Leslies cited 26 C.F.R. § 1.263(a)-2(e) (which lists "commissions paid in purchasing securities" among "capital expenditures"), Spreckels v. Helvering, 315 U.S. 626, 62 S.Ct. 777, 86 L.Ed. 1073 (1942) , and Soeder v. Commissioner, 13 T.C.M. (CCH) 200 (1954) . The Tax Court concluded, however, that the Leslies' reliance on all three sources was "unfounded since both the regulation[ ] and the cases cited deal with taxpayers who were involved in securities or commodities transactions entered into primarily for profit." Leslie, 71 T.C.M. (CCH) at 2242.

On appeal, the Leslies raised the very same argument (citing the very same authorities) that they had raised before the Tax Court, and made no attempt whatsoever to counter the Tax Court's rejection of that argument. The Tax Court followed clearly established precedent in disallowing the deduction of fees arising out of tax-motivated (as opposed to profit-motivated) investments. The court in Ewing unmistakably held that where taxpayers "entered into their straddle transactions primarily to obtain tax deductions, the fees paid by petitioners constituted payments to purchase such deductions and are nondeductible personal expenditures." Ewing, 91 T.C. at 421; see also Brown v. Commissioner, 85 T.C. 968, 1000, 1985 WL 15423 (1985) ("Inasmuch as we have found that the program was operated solely to provide tax deductions for its participants, the fees constituted payments

to purchase such deductions and as such are, at best, personal expenditures which are not deductible."), aff'd sub nom., Sochin v. Commissioner, 843 F.2d 351 (9th Cir.1988) . The Tax Court's resolution of the fees issue comports with common sense. In view of the tax code's proscription against deducting losses incurred on tax-motivated transactions, it would be anomalous indeed if the commissions paid to procure those losses were themselves deductible. In light of the clear, and eminently sensible, distinction drawn in Tax Court precedent between fees paid in profit-motivated transactions and fees paid in tax- motivated transactions, we affirm the Tax Court's decision that the Leslies are not entitled to deduct the fees and commissions paid to Hunter.

V

Finally, the Tax Court held that the Leslies were liable for increased interest on their underpayment pursuant to 26 U.S.C. § 6621(c). [FN4] Its decision in that respect is an issue of statutory construction, subject to de novo review. See Parravano, 70 F.3d at 543.

The Commissioner seeks enhanced interest pursuant to 26 U.S.C. § 6621(c) on tax liabilities that remained outstanding after December 1, 1984, the statute's effective date. [FN5] Section 6621(c)(3)(1) provides for enhanced interest rate of 120% of the underpayment rate on any "substantial underpayment attributable to tax motivated transactions." Within the meaning of the statute, "substantial underpayment" refers to any liability exceeding $1000 in a given taxable year. See 26 U.S.C. § 6621(c)(2). More importantly, for purposes relevant to this appeal, § 6621(c)(3)(A)(iii) provides that " 'tax motivated transaction' means ... any straddle (as defined in section 1092(c) without regard to subsections (d) and (e) of section 1092)."

[7] Section 1092(c)(1) defines the word "straddle" in the following terms: "The term 'straddle' means offsetting positions with respect to personal property." An "offsetting position with respect to personal property" occurs "if there is a substantial diminution of the taxpayer's risk of loss from holding any position with respect to personal property by reason of his holding 1 or more other positions with respect to personal property (whether or not of the same kind)." 26 U.S.C. § 1092(c)(2)(A).

The Leslies correctly note that § 1092 itself "appl[ies] to property acquired and positions established by the taxpayer after June 23, 1981, in taxable years ending after such date." Pub.L. No. 97-34, § 508(a) (printed in notes following 26 U.S.C. § 1092). They contend that because their "positions" were "established" prior to June 23, 1981, § 1092 does not "apply" to their transactions, and, therefore, that § 6621(c)(3)(A)(iii)-- which incorporates § 1092's definition of straddle--does not apply to their transactions either. The Leslies' argument is interesting but ultimately unavailing. The Leslies are undoubtedly correct that the substantive provisions of § 1092 itself, and the tax consequences that follow therefrom, do not apply to their transactions. Subsection 1092(a)(1)(A), for instance, provides that

[a]ny loss with respect to 1 or more positions shall be taken into account for any taxable year only to the extent that the amount of such loss exceeds the unrecognized gain (if any) with respect to 1 or more positions which were offsetting positions with respect to 1 or more positions from which the loss arose.

Clearly, neither that provision nor any tax liability that it might trigger apply to the Leslies' straddle transactions. In this case, however, the Tax Court did not "apply" § 1092 as

such. The only Internal Revenue Code provision being "applied" to the Leslies' transactions was § 6621. Section 6621--not § 1092--is the only provision relevant to the interest enhancement issue under which any tax consequences were alleged.

Section 6621(c)(3)(A)(iii) references § 1092 for one simple reason: § 1092 contains what the drafters of § 6621 deemed to be a useful definition of "straddle." In the interest of expediency, rather than trotting out the same exact definition again, they simply cross referenced § 1092, which a prior Congress had already adopted. The effect, however, is the same. To repeat, § 6621(c)(3)(A)(iii) provides that " 'tax motivated transaction' means ... any straddle (as defined in section 1092(c))." Section 1092, in turn, defines "straddle" as an "offsetting position[ ] with respect to personal property."

Consequently, § 6621(c)(3)(A)(iii)--the section under which the Commissioner is seeking the enhancement--might as well say that " 'tax motivated transaction' means ... any ... offsetting position[ ] with respect to personal property." When the substitution is explicitly made, it becomes clear that the Leslies' challenge to the Tax Court's imposition of enhanced interest must fail. No one disputes that the straddles that the Leslies entered into were "offsetting positions with respect to personal property"; hence, they were within the substantive definition of "straddle" incorporated by reference into § 6621(c)(3)(A)(iii). We therefore hold that notwithstanding the fact that the Leslies established their straddle positions after the June 23, 1981 effective date of § 1092, their straddles are nonetheless "straddles" within the meaning of § 6621(c)(3)(A)(iii).

The case law provides strong support for our interpretation. Indeed, Solowiejczyk v. Commissioner, 85 T.C. 552, 1985

WL 15399 (1985) , aff'd without opinion, 795 F.2d 1005 (2d Cir.1986) , is almost directly on point. In that case, the Commissioner sought increased interest pursuant to § 6621(c)(3)(A)(i), which defines "tax motivated transaction" as "any valuation overstatement (within the meaning of section 6659(c))." The taxpayer there argued that § 6621(c)(3)(A)(i) did not apply to him, because the provision that included the referenced definition of "valuation overstatement"-- § 6659--was effective only for tax returns filed after December 31, 1981, which his was not. The argument, which runs directly parallel to the argument advanced by the Leslies, was squarely rejected by the Solowiejczyk court:

> The issue for decision herein centers upon the imposition of an increased rate of interest pursuant to 6621(c). Section 6659(c) comes under consideration only with respect to the definition of valuation overstatement contained therein, which is incorporated by reference into section 6621(c)(3)(A)(i). Although section 6659(c) is effective only for tax returns filed after December 31, 1981, no addition to tax pursuant to section 6659 is sought herein and, therefore, the [date] limitation with respect to that statute is irrelevant. Section 6621(c) was enacted on July 18, 1984, and is effective as to interest accruing after December 31, 1984. Respondent here seeks to apply that section to interest which accrued after December 31, 1984, on petitioner's underpayment of their 1978 tax liability.

Id. at 555. [FN6]

[8] In addition to Solowiejczyk, there is further circumstantial evidence from the annals of Tax Court precedent suggesting that the government's construction of § 6621(c)(3)(A)(iii)--as merely referencing § 1092 for the definition of straddle--is the proper one. First and foremost, there is very specific Tax Court precedent for applying § 6621(c)(3)(A)(iii) to straddles--like the Leslies'--entered into

prior to the June 23, 1981 effective date of § 1092. For instance, in Walker v. Commissioner, 60 T.C.M. (CCH) 1340 (1990) , the court specifically noted that § 6621(c)(3)(A)(iii) defined "tax motivated transaction" to include "any straddle (as defined in section 1092(c) ...)." The court nonetheless concluded that straddles entered into in 1979--well before the June 23, 1981 cutoff date--were subject to the enhanced interest provisions of § 6621. Moreover, in a number of decisions, the Tax Court has, when quoting § 6621(c)(3)(A), affirmatively omitted reference to § 1092. Instead, the cases provide that the term "tax motivated transaction" means "(iii) any straddle * * *." E.g. Segal v. Commissioner, 64 T.C.M. (CCH) 99, 116 (1992) , aff'd without opinion, 41 F.3d 1144 (7th Cir.1994) ; Taft v. Commissioner, 54 T.C.M. (CCH) 962, 968 (1987) . In still other Tax Court decisions, the court has paraphrased § 6621(c)(3)(A) as including "any straddle," without any ellipsis or specific reference to § 1092. E.g., Ewing, 91 T.C. at 422; Starr v. Commissioner, 62 T.C.M. (CCH) 1417, 1422 (1991) . Both groups of cases--those that substitute " * * * " for § 1092 and those that make generic reference to "straddles" without any mention of § 1092 whatsoever--confirm that the Tax Court views § 1092 as relevant to the § 6621 analysis solely for the purposes of definition. We approve the Tax Court's interpretation. [FN7]

VI

The Tax Court was correct to deny the Leslies the relief they requested. Its decision is affirmed in all respects.
AFFIRMED.

Footnotes

FN1. Straddles come in all shapes, sizes, and--well--species: there are forward straddles and backward straddles, bull

straddles and bear straddles, butterfly straddles and condor straddles. Each presents its own financial risks and rewards. See the Tax Court's decision, Leslie v. Commissioner, 71 T.C.M. (CCH) 2233 (1996) .

FN2. In addition to the substantive claims discussed infra, the Leslies argued that the Tax Court erred in admitting the report and testimony of the Commissioner's expert witness, Dr. Richard Teweles. In view of our treatment of the Leslies' tax-law-based contentions, we need not address the evidentiary issue.

FN3. Congress enacted § 108 in 1984 "to clarify the law governing [pre- 1982] straddles." Because § 108 was solely retroactive, dealing only with transactions consummated before 1982, it was never codified in the Internal Revenue Code. Horn v. Commissioner, 968 F.2d 1229, 1233 n. 5 (D.C.Cir.1992) . Rather, § 108 appears only in the notes following 26 U.S.C. § 1092.

FN4. Section 6621(c) was repealed in 1989; however, the repeal is effective only for returns due after December 31, 1989, and is therefore inapplicable to the Leslies' appeal. See Feldman v. Commissioner, 20 F.3d 1128, 1136 (11th Cir.1994) .

FN5. It is well settled that § 6621 applies to interest accruing after December 31, 1984, even though the transaction at issue was entered into prior to that date. See, e.g., Carberry v. Commissioner of Internal Revenue, 933 F.2d 1124, 1129 (2d Cir.1991) ; Kennedy v. Commissioner, 876 F.2d 1251, 1256 (6th Cir.1989) ; Solowiejczyk v. Commissioner, 85 T.C. 552, 555-57, 1985 WL 15399 (1985) , aff'd, 795 F.2d 1005 (2d Cir.1986) .

FN6. At the time Solowiejczyk was decided the section number was 6621(d), not 6621(c). For convenience, however, we refer to the provision as § 6621(c).

FN7. In the end, even apart from § 6621(c)(3)(A) and the potential interpretive difficulties that it engenders, see Robert B. Martin, Jr., Coping with the Tax Shelter Registration and Compliance Requirements, 62 J. Tax'n 2, 6 (1985), the Commissioner possesses the authority to impose the enhanced interest penalty pursuant to § 6621(c)(3)(B). Pursuant to § 6621(c)(3)(B), "[t]he Secretary [of the Treasury] may by regulations specify other types of transactions which will be treated as tax motivated." Under that grant of authority, the Secretary promulgated § 301.6621-2T, which adds to § 6621's list of five specific tax motivated transactions "[a]ny deduction disallowed for any period under section 165(c)(2), relating to any transaction not entered into for profit." 26 C.F.R. § 301.6621-2T, Q & A-4. We have already expressed our view that the Leslies' straddle transactions were not "entered into for profit" within the meaning of DEFRA § 108(a). See supra Part II. DEFRA § 108(a) merely "restates [the] existing law" under 26 U.S.C. § 165(c)(2). See 26 C.F.R. § 1.165-13T , Q & A-2; see also Dewees v. Commissioner, 870 F.2d 21, 29 (1st Cir.1989) ("Congress enacted § 108 to clarify the application of the general loss deduction rule of § 165 to straddle transactions."). The determination whether or not certain transactions were "entered into for profit" is measured by the same standard in both sections. See, e.g., Ewing, 91 T.C. at 417. Indeed, the Leslies candidly conceded as much in their briefs to this court. Consequently, because the Leslies' claimed deductions were "deduction[s] disallowed ..., relating to any transaction not entered into for profit," they fit within the enhanced interest Treasury Regulation adopted pursuant to § 6621(c)(3)(B). See, e.g., id. at 422; Thurner v. Commissioner, 60 T.C.M. (CCH) 961, 976-77 (1990)

T.C. Memo. 1996-861996 WL 83310 (U.S.Tax Ct.), 71 T.C.M. (CCH) 2233, T.C.M. (RIA) 96,086

Robert G. LESLIE and Marilyn B. Leslie, Petitioners,
v.
COMMISSIONER OF INTERNAL REVENUE, Respondent.

No. 9814-87.

United States Tax Court.

Feb. 28, 1996.

Elliott H. Kajan and Steve Mather, Beverly Hills, CA, for petitioners.

Roger L. Kave, Encino, CA, for respondent.

MEMORANDUM FINDINGS OF FACT AND OPINION

FAY, Judge:

By notice of deficiency dated February 20, 1987, respondent determined deficiencies in petitioners' Federal income taxes and additions to tax and increased interest as follows:

		Additions to Tax and Increased Interest			
Year	Deficiency	Sec. 6621(d)	Sec. 6653(a)(1)	Sec. 6653(a)(2)	Sec. 6661
1980	$1,064,080	1	$53,204	--	--

1981	49,501	1	2,475	1	--
1982	366,677	1	18,334	1	$91,669

FN1To be determined.

All section references are to the Internal Revenue Code in effect for the taxable years in issue, and all Rule references are to the Tax Court Rules of Practice and Procedure, unless otherwise indicated.

This case involves Robert G. Leslie's (petitioner's) investments in gold straddle transactions through the futures commission merchant F.G. Hunter & Associates (Hunter). This is the same Hunter tax straddle program that was at issue in Ewing v. Commissioner, 91 T.C. 396 (1988) , affd. without published opinion 940 F.2d 1534 (9th Cir. 1991) .

On August 30, 1993, respondent filed a Motion for Order to Show Cause why petitioners' case is different than Ewing v. Commissioner, supra. On October 18, 1993, petitioners filed Petitioners' Response To Order To Show Cause. In their response, petitioners submit that their primary motive for engaging in gold futures transactions with Hunter is distinguishable from that of the taxpayers in Ewing v. Commissioner, supra. Based on petitioners' response, on December 6, 1993, this Court issued an order discharging the order to show cause. A trial was held January 10 and 11, 1995, in Los Angeles, California, to resolve the following issues for decision:

(1) Whether certain transactions in gold futures were entered into by petitioners for profit. We hold that they were not.

(2) Whether fees paid by petitioners with respect to such transactions are deductible. We hold that they are not.

(3) Whether petitioners are entitled to a deduction for the taxable year 1982 for the amount by which the Hunter straddle losses for the years at issue exceed the straddle gains for the years at issue. We hold that they are not.

(4) Whether petitioners, with regard to the Hunter straddle transactions, are liable for increased interest pursuant to section 6621(d). We hold that they are.

Respondent concedes that, based on the holding in Ewing v. Commissioner, supra, petitioners are not liable for additions to tax pursuant to section 6653(a)(1) and (2). Respondent further concedes that petitioners are not subject to an addition to tax for the taxable year 1982 pursuant to section 6661.

FINDINGS OF FACT

Some of the facts have been stipulated and are so found. The stipulation and exhibits associated therewith are incorporated herein by reference.

At the time petition was filed, petitioners resided in Santa Paula, California. Petitioners' joint Federal income tax returns for the years in issue were filed with the Office of the Internal Revenue Service at Fresno, California. Petitioners' returns were prepared utilizing the cash receipts and disbursements method of accounting.

On their joint Federal income tax returns for the 1980 taxable year, petitioners claimed ordinary losses from Hunter transactions for the cancellation of long gold futures contracts in the amount of $1,530,268, and short-term capital gains for offset transactions of $198,030. Petitioners also claimed as miscellaneous itemized deductions for the taxable year ending December 31, 1980, the following costs relating

to their participation in Hunter transactions: Investment advisory fees in the amount of $14,000 and legal fees related to investments in the amount of $3,500.

On their joint Federal income tax return for the 1981 taxable year, petitioners claimed an ordinary loss from Hunter transactions for the cancellation of long gold futures contracts in the amount of $55,302 and net long-term capital gains from the assignment and offset of Hunter gold futures contracts in the amount of $97,160.

On their joint Federal income tax returns for the 1982 taxable year, petitioners claimed net long-term capital gains from Hunter transactions for the assignment and offset of gold futures contracts in the amount of $1,172,950.

All of the above claimed tax results purportedly occurred with respect to transactions in gold futures conducted during 1980, 1981, and 1982 in the manner hereinafter described on behalf of petitioners by Hunter. Petitioners did not engage in the transactions as dealers.

Trading in Commodities Futures in General

A gold futures contract [FN1] is an agreement to either deliver (a short position [FN2]) or receive (a long position [FN3]) a specified amount of gold during a designated month at a price negotiated when the contract is made. The futures contract is ultimately fulfilled when the commodity bought is delivered to the buyer by the seller or when the contract is offset. Less then 5 percent of all futures contracts actually result in the delivery of the underlying commodity. Instead, most futures contracts are offset rather than being executed by delivery. Ewing v. Commissioner, supra at 400 . An offset

is the acquisition of an offsetting contract of purchase or sale of the same quantity of the commodity.

A gold spread consists of a long position and a short position, with each position having a different delivery date. Each of the two positions constitutes a simple spread, often referred to as a "leg". Id. If a trader merely bought a long position or sold a short position, he would be said to have acquired a "simple net position", and the trader would hope to profit by a rise in the price of the commodity underlying the long position or fall in the price of commodity underlying the short position. Traders who invest utilizing spread positions hope to profit by a favorable change in the price relationship or differential between their long and short positions. The price differential is a function primarily of the changes in short-term interest rates and the value of the underlying commodity [FN4] and, secondarily, of storage and commission costs. Since storage costs for precious metals are trivial, the major forces affecting gold futures spreads are gold prices and short-term interest rates. Id.

A simple commodity spread that has one short leg with a nearby delivery date and one long leg with a more distant delivery date is often referred to as a "backward spread" since it is profitable when the dollar difference between the price of the two contracts increases after the position is established.

Since prices generally increase in a rising or bull market, backward spreads are also referred to as "bull spreads". Conversely, a simple commodity spread that has a long leg with a nearby delivery date and one short leg with a more distant delivery date is referred to as a "forward spread" since it is profitable if the dollar difference between the two contracts declines after the position is established. Since prices

generally decline in a falling or bear market, forward spreads are also referred to as "bear spreads".

Since a forward spread profits when the difference between the two contracts narrows, a forward spread will profit when the interest rates decline. Conversely, a backward spread would suffer a loss from the same change in interest rates. Additionally, since a forward spread profits when the spread difference narrows, a forward spread will profit from a reduction in the price of gold even if the interest rates do not change. Conversely, a backward spread would suffer a loss from the same reduction in the price of gold.

Whenever a leg of a straddle is closed out by an offset, or in any other manner, tax consequences normally will result in the holder realizing either a gain or a loss. Generally, in a tax-motivated straddle trading, the loss leg will be closed out first in order to generate a tax loss for the holder. When this occurs, the remaining leg of the initial straddle containing an unrealized gain, which is usually almost identical to the amount of loss in the closed leg, constitutes an open position for the holder and thus is subject to the increased risk of being directly subject to the market. To minimize this increased risk, the holder would obtain a new position similar to the one in the closed loss leg, except for a different month. This substitution of one position for a similar position in a different month (switching) of the loss leg in the initial year in order to generate a tax loss which is offset by the unrealized gain in the other leg of the straddle is a pattern usually found in the trading of tax straddles. Ewing v. Commissioner, 91 T.C. at 401 .

A "butterfly spread" has three legs maturing at different times. If the first and third legs are long, then the middle position is short. If the first and third legs are short, then the

middle position is long. The outlying positions (first and third legs) are referred to as wings and the center position as the body, hence the term "butterfly".

The center position or body of a butterfly spread is twice as large as either wing, and the time periods for the delivery of the commodity from the first wing to the body and from the body to the second wing are equal. Essentially, a butterfly spread creates two spreads, one bullish and one bearish. Thus, a butterfly spread presents less chance of either an adverse or a favorable spread movement and is, therefore, less likely to result in a different loss or gain than an ordinary straddle. An example of a butterfly spread would be as follows:

WING — Short 50 Contracts of June Gold

WING — Short 50 Contracts of October Gold

BODY — Long 100 Contracts of August Gold

A "condor trade" is similar to a butterfly spread but has four or more elements rather than three. An example would be as follows:

WING — Short 50 Contracts of June Gold

WING — Short 50 Contracts of December Gold

BODY — Long 50 Contracts of August Gold
Long 50 Contracts of October Gold

The purpose of butterfly or condor spreads is to establish a position that will create a significant profit or loss on the long or short position if there is a major move in the price of gold so a tax benefit can be achieved. At the same time, such a

spread establishes a position that creates a complementary profit or loss on the other side of the position, thereby creating tax benefits while eliminating the possibility of gaining or losing significant equity.

The Hunter Program

Hunter was organized in late 1979 or early 1980 as a Nevada limited partnership with its principal place of business in Newport Beach, California. On February 20, 1980, Hunter first registered with the Commodities Futures Trading Commission (CFTC) as a Futures Commission Merchant (FCM) and remained an FCM for all years relevant hereto. All regulated futures transactions must be executed through an FCM which is a member of an exchange. Since Hunter was not a member or clearing member of the Commodity Exchange of New York (COMEX) or the International Money Market (IMM), Hunter was not authorized to execute gold futures contracts on the floor of either exchange. Accordingly, Hunter contracted with A.G. Becker, Inc., a clearing member of the exchanges, to execute and clear the gold futures transactions involved herein.

Hunter delivered promotional literature to prospective clients. A majority of the promotional material was devoted to showing clients the "significant tax advantages" they could obtain through the Hunter investment program.

Most of the "Questions and Answers" portion of the Hunter promotional material relates specifically to tax benefits that can be received by participating in the Hunter program. Specifically, the materials state:

3. Can I lose my investment?

Yes. As with any investment, the risk of loss is commensurate with the opportunities for profit. However, the opportunity for profit can be considerably enhanced, and the risk of loss substantially reduced by the proper choice of alternative methods of liquidating your contracts.

* * *

8. How can the probability of gain be increased by choice of liquidation methods (?) (See #3)
Income tax treatment of your gains or losses on each contract will be different depending upon the way your contract is closed out. There are ways to close out a contract in which you have a gain so that it will be taxed as a long term capital gain. For the contract in which you have a loss, you may liquidate so as to have ordinary loss. Depending upon your tax bracket, your risk of after tax loss on both of these contracts will be very substantially reduced and will quite possibly be converted into an after tax gain. Any net pre-tax profit will be significantly increased.

9. Can you give me an example ?
On February 15, 1978, the price of November 1978 gold was $188.30 per ounce (Wall Street Journal, February 15, 1978 CMX). On the same date, the price of February 1979 gold was 192.30 per ounce. Seven months later on September 20, 1978, the price of November 1978 gold was $212.70, and the price of February 1979 gold was $217.90. If you had sold November 1978 gold on February 15, 1978, and bought February 1978 gold at the same time then liquidated each contract on September 20, 1978, you would have incurred a loss of $24.40 ($212.70 - $188.30) per ounce on your short position and realized a gain of $25.60 per ounce on your long position. Based on current tax rates, and upon the assumption that you close out your positions as described above, your net

after tax gain on your February 15, 1979 gold would have been approximately $20.48 per ounce, and your net after tax loss on November 1978 gold would have been approximately $12.20 per ounce. The combined after tax gain would have been $8.28 per ounce. Considering there are 100 ounces of gold per contract your net dollar profit would be $828.00 per spread. These figures do not include sales and administrative fees which will be discussed later.

10. What would have happened if I had bought November 1978 gold and sold February 1979 gold instead?
On your long (November) contract, you would have a before tax gain of $24.40 per ounce, and on your short (February) position a before tax loss of $25.60 per ounce. Your after tax gain on the long contract would be approximately $19.52 per ounce, and your after tax loss on your short contract would have been approximately $12.80 per ounce, if you follow the liquidation principles described in the answer to question #9 above. The combined after tax gain would be $6.72 per ounce, or $672.00 net after tax profit per spread.

11. Would the same results be realized with other choices of dates?
The results that would have been achieved with other choices of dates would be different. However, the principles are the same if these conditions apply. (1) The contracts are closed out after the expiration of the six months capital gains holding period. (2) The contract on which you have a gain is closed out in a way which will qualify for capital gains tax treatment, and (3) the contract on which you have a loss is closed out in a way which will qualify for ordinary income tax treatment.

12. Precisely how do I meet conditions (2) and (3) in question # 11?

If there is a gain in your long position, you should qualify for capital gains treatment by going short in the same delivery month. If you have a gain in your short position, you could sell it to an unrelated third party and qualify for capital gains treatment. If you have a loss in either your long or short contract, you should cancel it. If you do, your loss will be an ordinary loss rather than a capital loss.

* * *

15. Will I be required to close out my long and short positions simultaneously?
By no means. They are separate contracts. You may choose to liquidate them in other ways. For example, you may wish to actually take delivery of the gold on your long contract and close out your short position by offsetting it with an identical long contract. Other combinations of liquidation are possible. You should select the one that fulfills your economic goals and personal requirements. Get the advice of your tax adviser.
Included with the promotional material are four graphs which show pre- and post-tax analyses of contract liquidation. The promotional material also contained a "Worksheet" which specifically allows for calculating the "Tax Savings" of contract liquidation.

Also provided with the Hunter promotional material was a four-page document entitled "Summary of Federal Income Tax Consequences of F.G. Hunter & Associates Investment Program", giving a synopsis of the different tax implications of various gold futures contract liquidation methods.

The Hunter promotional materials included a 24-page opinion letter, dated March 24, 1980, written by Attorney Avram Salkin. The opinion letter was supplemented on June 13,

1980, and modified on August 17, 1981, in light of the provisions of the Economic Recovery Tax Act of 1981, Pub. L. 97-34, 95 Stat. 172. The opinion letter described in detail, with supporting citations of case law and statutes, the tax consequences, which in, the opinion of Mr. Salkin, could be expected by Hunter investors from the liquidation of the component positions of their future straddles.

Petitioner's Business and Investment History

At the time of trial, petitioner was 62 years old. Petitioner graduated from high school in 1950 and enlisted in the U.S. Army. After being honorably discharged from the Army in 1953, petitioner entered the construction business. Petitioner eventually became the president and sole shareholder of R&H Paving, Inc., a paving contractor.

Prior to making the commodity trades with Hunter, petitioner held various investments during the 1970's and early 1980's. Petitioner's basic requirement in an investment was a good cash-flow, in order to counter the cyclical nature of his construction business. Petitioner was not averse to risk in an investment since he was accustomed to a considerable amount of risk from the construction industry.

Generally, petitioner relied on either Roy Tolson, an accountant and business adviser, or Joe Rasey, a business associate, to locate investments which satisfied his investment criteria. Before making an investment, petitioner would personally analyze the transaction.

In June 1980, petitioner hired Donald Short (Short) to be his personal business adviser and controller for R&H Paving, Inc. Short was a certified public accountant (C.P.A.), licensed to practice in California. Prior to being hired by

petitioner, Short was employed by Edward White & Co., the C.P.A. firm that prepared petitioners' tax returns. While Short worked at Edward White & Co., he prepared petitioners' tax returns. Short testified that he was well aware of petitioner's tax position during the years he prepared petitioners' tax returns at Edward White & Co. and for all the taxable years at issue.

Petitioner relied on Short to find investments that satisfied his investment criteria because petitioner did not have time to personally investigate all of the potential investments in which he was interested. As part of Short's investigation of potential investments for petitioner, Short read books, articles, and periodicals relating to commodity trading which led Short to believe that this type of investment met petitioner's investment requirements.

Since neither Short nor petitioner had prior experience with commodity investments, Short searched for brokerage firms that had commodity departments. Short searched for a commodity broker by contacting brokerage houses and persons he had worked for in the past, including Edward White & Co. These sources led Short to Hunter and, in particular, to Russ Klein (Klein), who was employed by and in charge of Hunter.

Short met with Klein on three occasions before investing with Hunter. Petitioner only attended the last meeting. The initial meeting with Klein focused on commodity trading methods and a projected potential return of 25-47 percent. Short believed that the Hunter trading methods met all of petitioner's investment criteria. Additionally, Short believed that Klein would be able to educate him in commodity trading strategies in order to enable him to assume increasing degrees of control over trading decisions in the future on behalf of petitioner. Short was very interested in the Hunter

program and advised petitioner of the substance of the initial meeting with Russ Klein. Short testified that he did not receive the promotional material nor learn about the favorable tax benefits of straddle trading in the Hunter program until his final meeting with Klein, which petitioner attended.

Petitioner testified that he reviewed the Hunter promotional material, including "Summary of Federal Income Tax Consequences" and discussed the tax consequences of the Hunter program with Short prior to making his actual Hunter investment. Petitioner did no further research regarding the Hunter program. Petitioner testified that he did not check into any of the credentials of the individuals who wrote the Hunter promotional material.

Petitioner decided to make his investment with Hunter in December 1980 based on the information Short obtained from his meetings and conversations with Klein and due to repeated calls from Klein urging him to make an investment with Hunter immediately. Klein's reason for wanting petitioner to invest at that time was that the volatility of the gold market presented an opportunity for immediate tax benefits. Short testified that some of the considerations for investing in Hunter programs at that time were to maximize profits during a volatile market and to take advantage of the tax benefits.

Petitioner, as a participant in the Hunter gold futures spread program, would have been required to sign the following Hunter forms: (a) New Account Application; (b) Account Agreement and Risk Disclosure; (c) Risk Disclosure Statement; and (d) Current Policies and Fees, setting forth the commissions and fees payable by petitioner to Hunter. Petitioner testified that it was normal practice in his business to keep copies of signed documents. However, at trial,

petitioner could not provide signed copies of any of the Hunter documents listed above.

Petitioner's initial commodity positions were created on December 1, 1980, when he made the investment. Petitioner paid an initial deposit of $178,500. Out of his initial deposit, petitioner incurred the following costs:

Legal fee	$3,500
Management fee	35,000
Commission to establish initial spread positions	17,500
Total costs	56,000

Thus, petitioner's initial margin was $122,500 ($178,500 - $56,000).

Petitioner's trades with Hunter were initiated by FAX, Inc. (FAX), a registered trading adviser. In order for FAX to initiate trades between petitioner and Hunter, petitioner would have been required to sign both an "Investment Advisory Agreement" and a "Special Power of Attorney" authorizing FAX to trade commodities. At trial, petitioner was unable to provide signed copies of these documents and testified that he did not recall signing either of the documents.

The $35,000 management fee incurred by petitioner on December 1, 1980 (see above), was for FAX's services. Short testified that he never investigated FAX because he felt that FAX was just part of Hunter and that the $35,000 fee was just being paid to Hunter.

Through Hunter, petitioner established two spreads on December 1, 1980. The first was a simple bear spread consisting

of a long position of 30 contracts of October 1981 100-ounce gold at a price of $723.80 per ounce and a matching short position of 30 contracts of February 1982 gold at $762. The second position was an imperfect butterfly spread. The first wing consisted of 70 contracts of April 1982 gold bought at $785.10. The body was 145 short June 1982 gold, of which 70 contracts were sold at $804.50 on COMEX and 75 contracts at $803.50 on IMM. The second wing was comprised of 75 contracts of September 1982 gold bought on IMM at $834. The slight imperfection in the butterfly occurred because there were only 2 months between the first wing and the body, whereas there were 3 months between the second wing and the body; and because the June/September part of the spread consisted of 75 contracts, whereas the April/June part consisted of 70 contracts.

On December 10, 1980, petitioner's spread positions were modified as a result of a recommendation from Klein that the market was moving and that, by making additional trades, petitioner could realize substantial tax losses and be in a better position to later profit from the market movement. Short and petitioner approved the trades that resulted in a substantial tax loss on December 10, 1980.

On December 10, 1980, the three long positions (175 gold contracts) established on December 1, 1980, were all canceled, resulting in losses totaling $1,506,000. Petitioner's original equity in his Hunter account, however, was not significantly affected because the value of the three remaining short positions dropped about as much as the three liquidated long positions. The result was a total "open" profit that approximately equaled petitioner's closed transaction loss.

Petitioner's open profit was protected by immediately replacing, on December 10, 1980, the 175 canceled long contracts with 175 new long contracts.

The new long positions established on December 10, 1980, consisted of 75 contracts of March 1982 gold at $685 and 100 contracts of August 1982 gold at $739.70. The resulting position in the account was an imperfect condor spread consisting of two long outside wings of 75 contracts of March 1982 at $685 and 100 contracts of August 1982 at $739.70 and the body consisting of two short positions, 30 contracts of February 1982 at $762 and 145 contracts of June 1982, of which 70 were established at $804.50 on COMEX and 75 at $803.50 on IMM.

Upon canceling the 175 gold positions on December 10, 1980, Hunter charged petitioner a cancellation fee totaling $15,520.14. As a result of the $1,506,000 tax loss, petitioner, for the tax year 1980, was able to offset net ordinary income from numerous sources totaling $1,449,151 and offset capital gains totaling $56,849.

On December 30, 1980, petitioner's position with Hunter was reduced by selling 21 contracts of March 1982 long position while at the same time liquidating 21 contracts of the June 1982 short position.

Short and petitioner were dissatisfied with the investment advisory services rendered by FAX, and in February 1981 they requested and obtained a refund of the $35,000 management fee, which was recredited to petitioner's account by Hunter in increments of $28,000 and $7,000.

Short and petitioner continued to be dissatisfied with the services provided by Hunter. Accordingly, Short contacted

Bill Kearney at Merrill Lynch to determine what commodity advising services were available from Merrill Lynch. Petitioner retained Merrill Lynch and invested $100,000 in an oil and gas investment in late 1981. Merrill Lynch earned a $6,000 commission from the investment.

Short left petitioner's employ for approximately 1 year during the second half of 1981 and early 1982. During Short's absence, petitioner continued his commodity trading activity through Merrill Lynch and expanded into trading bonds, stocks, and other commodities futures contracts.

Also during Short's absence, petitioner continued to maintain his accounts with Hunter, and, on December 31, 1981, four of the March 1982 long positions were sold at $409, creating a total loss in the amount of $110,400. Two of the contracts were disposed of by sale, for which petitioners claimed a long-term capital loss in the amount of $55,200 on their 1981 Federal income tax return. Two of the contracts were disposed of by "cancellation", for which petitioners claimed an ordinary loss deduction in the amount of $55,302 on their 1981 Federal income tax return.

To keep the number of long and short positions of the condor position balanced after the December 31, 1981, disposal of four long contracts, four short contracts of June 1982 gold were purchased at $422.55 for petitioner's account with Hunter. This purchase yielded a realized profit of $152,380. The December 31, 1981, liquidation of four short positions was treated by petitioner as an "assignment" to a third party, and the gain was treated as a $152,380 long-term capital gain on petitioners' tax return.

In January 1982 petitioner and Hunter continued to reduce the condor position. This was made necessary by the fact that

all the remaining gold contract positions consisted of 1982 contracts and would have to be settled by delivery if held much longer. As a result of the impending delivery dates, petitioner liquidated 30 of the remaining long August positions on January 26, 1982. The repositioning resulted in an offset loss of $1,007,100, which petitioner treated as a long-term capital loss.

Also on January 26, 1982, an equivalent short position consisting of 30 contracts of February 1982 gold was liquidated, but, instead of being offset by a direct purchase on the trading floor of COMEX, the short position was "assigned". This assignment resulted in a profit of $1,149,450, which petitioners reported as a long-term capital gain on their 1982 Federal income tax return.

The liquidation continued on February 24, 1982, when 25 long March contracts were sold, and 25 short June contracts were assigned. Petitioner recognized an $802,500 loss from the offset of the March position, which he treated as a long-term capital loss. Simultaneously, petitioner recognized a $1,067,625 profit from the assigned short June position, which petitioner treated as a long-term capital gain.

On February 25, 1982, an additional 25 contracts on each side of the remaining spread position in the account were liquidated. Twenty-five long March 1982 contracts were offset at a loss in the amount of $797,500. Petitioner reported the loss as a long-term capital loss. Twenty-five short June 1982 contracts were liquidated by assignment at a gain in the amount of $1,062,125. Petitioner treated the gain as a long-term capital gain.

Petitioner liquidated his final positions with Hunter on May 26, 1982. This resulted in an offset loss of $2,814,700 from the remaining long contracts and a gain from the assignment

of the remaining short contracts of $3,315,550. The loss was treated by petitioner as a long-term capital loss, and the gain was treated as a long-term capital gain.

Petitioners claimed on their 1982 joint Federal income tax returns that the results of their 1982 Hunter trades were net long-term capital gains from the assignment and offset of gold futures contracts in the amount of $1,172,950.

OPINION

Losses on Straddle Transactions

The primary issue in this case is whether petitioners are entitled to deduct losses on the Hunter straddle transactions as claimed on their Federal income tax returns for the taxable years 1980, 1981, and 1982. Resolution of the issue turns on the effect of section 108(a) of the Deficit Reduction Act of 1984 (DEFRA), Pub. L. 98-369, 98 Stat. 494, 630, as amended by section 1808(d) of the Tax Reform Act of 1986, Pub. L. 99-514, 100 Stat. 2817. Hereinafter, our references to "DEFRA section 108" are to that section as amended, unless otherwise stated.

DEFRA section 108(a) provides as follows:
(a) General Rule. -- For purposes of the Internal Revenue Code of 1954, in the case of any disposition of 1 or more positions--
(1) which were entered into before 1982 and form part of a straddle, and
(2) to which the amendments by title V of the Economic Recovery Tax Act of 1981 do not apply,
any loss from such disposition shall be allowed for the taxable year of the disposition if such loss is incurred in a trade or

business, or if such loss is incurred in a transaction entered into for profit though not connected with a trade or business.

By notice of deficiency, respondent determined that petitioner's straddle losses are not deductible under section 165(c)(2) because the transactions were not entered into for profit. Petitioners contend that their entire course of conduct before the investment, during the commodity trading with Hunter, and after the initial Hunter investment through the time of the investment with Merrill Lynch all reflect that petitioner's gold straddle transactions were entered into for profit.

Petitioners contend that all of petitioner's investment and commodity trades were consistent with his long-standing investment history. They argue that petitioner's commodity spread trading was motivated primarily by petitioner's desire to find investments with a modicum of risk in exchange for a large cash return on investment, and that tax benefits were purely coincidental. We disagree.

This Court in Ewing v. Commissioner, 91 T.C. 396 (1988), stated that the phrase "entered into for profit" as used in DEFRA section 108(a) is to be interpreted by reference to the standard applied under section 165(c)(2). Ewing v. Commissioner, supra at 417. The Court in Ewing used the guidelines provided in Fox v. Commissioner, 82 T.C. 1001 (1984), to determine whether the Hunter gold straddle transactions were entered into primarily for profit. Id.

In Fox v. Commissioner, supra at 1021, this Court concluded that section 165(c)(2) requires that profit be the primary motive if a loss from a straddle transaction is to be deductible. The Court stated that profit need not be the sole motive for engaging in a straddle transaction, but that a mere

incidental profit motive would be insufficient. Id. at 1019 (citing Ewing v. Commissioner, 20 T.C. 216, 233 (1953), affd. 213 F.2d 438 (2d Cir. 1954)). To determine whether a straddle transaction was entered into for profit, Fox provides the following guidelines:

(1) The ultimate issue is profit motive and not profit potential. However, profit potential is a relevant factor to be considered in determining profit motive.

(2) Profit motive refers to economic profit independent of tax savings.

(3) The determination of profit motive must be made with reference to the spread positions of the straddle and not merely to the losing legs, since it is the overall scheme which determines the deductibility or nondeductibility of the loss.

(4) If there are two or more motives, it must be determined which is primary, or of first importance. The determination is essentially factual, and greater weight is to be given to objective facts than to self-serving statements characterizing intent.

(5) Because the statute speaks of motive in "entering" a transaction, the main focus must be at the time the transactions were initiated. However, all circumstances surrounding the transactions are material to the question of intent. Ewing v. Commissioner, 91 T.C. at 418 (citing Fox v. Commissioner, supra at 1018, 1022).

Although petitioner testified that his sole motive for investing with Hunter was to obtain a profit, a majority of the circumstances surrounding the transactions points to the conclusion that petitioner's primary motive was tax benefits.

In determining petitioner's primary motive for entering the Hunter program, "greater weight is to be given to objective facts than to self-serving statements characterizing intent." Ewing v. Commissioner, 91 T.C. at 418 ; Fox v. Commissioner, supra at 1022 . The objective facts indicate that petitioner's primary motive was tax considerations. Thus, after applying the Fox guidelines to the facts of this case, we find, for the reasons discussed below, that petitioner did not enter into his straddle transactions primarily for profit.

First, although petitioner testified that Hunter representatives never told him that canceling a commodities position would give him an ordinary tax loss or that he could get long-term capital gain treatment on the disposition of a short sale position, it is clear that the objective facts contradict this testimony.

A majority of the promotional material was devoted to showing clients the significant tax benefits that could be achieved through the Hunter "cancellation" and "assignment" closing procedures. Petitioner testified that he read and received the Hunter promotional material which explained the tax benefits to Hunter's liquidation procedures. Also, many of the "Questions and Answers" portion of the Hunter promotional material related specifically to tax benefits that can be achieved through the Hunter program. Furthermore, other Hunter promotional material received and read by petitioner included graphs comparing pre-and post-tax analyses of contract liquidation, a worksheet specifically allowing for the calculation of "Tax Savings" of contract liquidation, and a four-page document entitled Summary of Federal Income Tax Consequences of F.G. Hunter & Associates Investment Program.

The Court in Ewing stated that the 24-page opinion letter, written by attorney Avram Salkin, was the most influential item in the Hunter promotional material. Ewing v. Commissioner, 91 T.C. at 418. Petitioner testified that he received and read the opinion letter along with the other promotional material. In contrast to the substantial discussion of tax benefits, the profitability of the Hunter program was neither seriously discussed nor quantified.

Second, petitioner's trades indicate a greater interest in the tax advantages of the Hunter program than in obtaining a profit. Petitioner's expert, Edward Horowitz, testified that the gold market was very volatile in December 1980 and that there is a greater potential to profit in a volatile market. Thus, Klein was correct in advising petitioner to enter the market at that time. Mr. Horowitz also testified that petitioner's modification of his straddle position on December 10, 1980, which resulted in a substantial loss, actually increased petitioner's profit potential. While the Court does not disagree with Mr. Horowitz's opinion that the modification of petitioner's straddle increased his profit position, the Court finds that the modification was motivated by a desire to obtain a tax benefit. Petitioner placed his first straddle positions on December 1, 1980, and then, only 9 days later, he modified his positions as a result of a recommendation from Klein that the market was moving and that, by making additional trades, petitioner could realize substantial tax losses and be in a better position to later profit from the market movement. Petitioner's modifications resulted in a $1,506,000 loss just before the end of the 1980 tax year.

Petitioner argues that "the mere fact that tax benefits were realized does not mean the tax benefits were the reason for the transaction." However, "It is a fundamental legal maxim that the consequences of one's acts are presumed to be

intended." Fox v. Commissioner, 82 T.C. at 1022. We find that petitioner, like the taxpayers in Ewing, "chose to 'cancel' the initial losing legs of his straddles before the close of the 1980 tax year so as to generate an ordinary loss." Ewing v. Commissioner, 91 T.C. at 419. Then, in the following year, on December 31, 1981, petitioner chose to assign the profitable legs of his straddles which resulted in a $152,380 long-term capital gain.

Thus, with an initial investment of only $178,500, petitioner attempted to offset $1,449,151 of his net 1980 ordinary income [FN5] with his $1,506,000 tax loss from the December 10, 1980, cancellation of his gold futures transactions, and, by closing out the profitable legs of his straddle positions on December 31, 1981, by means of assignments, petitioner attempted not only to defer his straddle gains to 1981 but also to convert ordinary income into 1981 long-term capital gain.

Finally, the alternative liquidation techniques (i.e., cancellations and assignments) developed by Avram Salkin were used by Hunter to sell prospective investors on a scheme to achieve tax avoidance. Id. Specifically, the "cancellation" technique was devised so that its proponents could claim ordinary loss treatment rather than capital loss treatment. The "assignment" procedure was contrived so that Hunter investors could characterize straddle gains as long-term capital gains instead of short-term capital gains. However, to utilize these techniques and obtain their purported tax benefits, petitioner paid more in commissions and fees than he would have incurred had he liquidated his futures contract the usual way, by means of offset. Id. at 400, 419 .

For example, under Hunter's "Current Policies and Fees" statement, petitioner was charged a fee of $15,520.14 for canceling 175 gold futures contracts on December 10, 1980.

Had petitioner offset his 175 gold contracts instead of "canceling" those positions, his fee would have only been $1,750. The Court believes that petitioner was willing to pay substantially more fees to obtain ordinary loss deductions in the amounts of $1,506,000 and $55,200 for 1980 and 1981, respectively, especially since petitioners deducted the fees on their 1980 and 1981 Federal income tax returns.
For the reasons stated above, we hold that petitioners' motives in entering into these transactions, despite their arguments to the contrary, were primarily to obtain substantial tax benefits. As we stated in Ewing:

"we are cognizant of the fact that tax planning is an economic reality in the business world and the effect of tax laws on a transaction is routinely considered along with other factors, but nevertheless we reiterate that 'tax straddling * * * transactions can hardly be said to number among congressionally approved, sanctioned, or encouraged responses to the tax laws."

Ewing v. Commissioner, 91 T.C. at 420 (quoting Fox v. Commissioner, supra at 1025).

Fees Paid With Respect to Straddles

Petitioners deducted the following fees paid to Hunter in regard to petitioner's Hunter transactions:

1980

Cancellation fees	$15,518
Gold futures contract cost	8,750
Offset fees	420
Investment advisory fees	14,000
Legal fees investment related	3,500

1981

Cancellation fees	102
Offset fees	20

Petitioners contend that these fees were incurred in connection with the purchase and sale of capital assets. As such, petitioners argue that these fees are capitalized and form part of the cost basis (for purchase commissions) and an offset against the selling price (for disposition commissions). Petitioners cite section 1.263(a)-2(e), Income Tax Regs., and the cases of Spreckles v. Helvering, 315 U.S. 626 (1942) , and Soeder v. Commissioner, a Memorandum Opinion of this Court dated Mar. 11, 1954. Petitioners state that, as part of the cost basis and the selling price, such expenses form part of the loss from the trading which is otherwise allowable under DEFRA section 108(c).

Petitioner's reliance on section 1.263(a)-2(e), Income Tax Regs., Spreckles v. Helvering, supra, and Soeder v. Commissioner, supra, is unfounded since both the regulations and the cases cited deal with taxpayers who were involved in securities or commodities transactions entered into primarily for profit. Since we have found that petitioner entered into the Hunter gold futures program in order to obtain substantial tax benefits, the above-listed fees paid by petitioner constitute payments to purchase tax deductions and do not form part of the cost basis of petitioner's gold contracts or reduce the selling price of those contracts. Therefore, the fees paid by petitioner are nondeductible personal expenditures. Ewing v. Commissioner, 91 T.C. at 421 ; Brown v. Commissioner, 85 T.C. 968 (1985) , affd. sub nom. Sochin v. Commissioner, 843 F.2d 351 (9th Cir. 1988) ; Zmuda v. Commissioner, 79 T.C. 714 (1982) , affd. 731 F.2d 1417 (9th Cir. 1984) ;

Houchins v. Commissioner, 79 T.C. 570 (1982) ; see also Falsetti v. Commissioner, 85 T.C. 332 (1985) .

The 1982 Deduction

Petitioners contend that, if the Court determines that the spread transactions were not entered into for profit, DEFRA section 108(c) allows petitioners to take a net out-of-pocket loss for 1982. The net out-of-pocket loss would represent the amount by which petitioner's straddle losses during the subject years exceeded his straddle gains during the subject years. Respondent contends that petitioners are only entitled to offset petitioner's straddle gains by straddle losses to the extent of his straddle gains. See Ewing v. Commissioner, 91 T.C. at 421 .

DEFRA Section 108(c) provides as follows:
(c) Net Loss Allowed.--If any loss with respect to a position described in paragraphs (1) and (2) of subsection (a) is not allowable as a deduction (after applying subsections (a) and (b)), such loss shall be allowed in determining the gain or loss from dispositions of other positions in the straddle to the extent required to accurately reflect the taxpayer's net gain or loss from all positions in such straddle.

Further interpretation of DEFRA section 108(c) is provided by section 1.165-13T, Q&A-3, Temporary Income Tax Regs., 49 Fed. Reg. 33445 (Aug. 23, 1984), which states as follows:

Q-3. If a loss is disallowed in a taxable year (year 1) because the transaction was not entered into for profit, is the entire gain from the straddle occurring in a later taxable year taxed?
A-3. No. Under Section 108(c) of the Act the taxpayer is

allowed to offset the gain in the subsequent taxable year by the amount of loss (including expenses) disallowed in year 1.

This Court recently confronted this issue in Nolte v. Commissioner, T.C. Memo. 1995-57 , and held that DEFRA section 108(c) entitles taxpayers to offset straddle losses only to the extent of straddle gains. The taxpayers in Nolte, like petitioner, were involved in the Hunter program.

Petitioners argue that Nolte relies on interpretive section 1.165-13T, Q&A-3, Temporary Income Tax Regs., supra, for the proposition that DEFRA section 108(c) allows the offset of disallowed losses only against subsequent gains. Petitioners contend that the holding in Nolte is incorrect for two reasons. First, petitioners believe that section 1.165-13T, Q&A-3, Temporary Income Tax Regs., supra, does not imply that disallowed losses may only offset subsequent gains. Second, section 1.165-13T, Q&A-3, Temporary Income Tax Regs., supra, is invalid to the extent that it implies a contrary result to the plain language of DEFRA section 108(c). Petitioners cite Jackson Family Foundation v. Commissioner, 15 F.3d 917 (9th Cir. 1994) , affg. 97 T.C. 534 (1991) , to support the position that an interpretive regulation is not followed when it "fails to 'implement the congressional mandate in a reasonable manner.'" Id. at 920 (citing Pacific First Fed. Sav. Bank v. Commissioner, 961 F.2d 800, 803 (9th Cir. 1992) , revg. 94 T.C. 101 (1990) (quoting National Muffler Dealers Association v. United States, 440 U.S. 472, 476 (1979))). We disagree with petitioners' position.

Petitioners incorrectly contend that section 1.165-13T, Q&A-3, Temporary Income Tax Regs., supra, does not imply that disallowed losses may only offset subsequent gains. The plain language of the regulations states that result. Section 1.165-13T, Q&A-3, Temporary Income Tax Regs., supra,

specifically states that "the taxpayer is allowed to offset the gain in the subsequent taxable year by the amount of loss (including expenses) disallowed in year 1." Thus, the plain language of the regulations is clear that a taxpayer can offset gain in a subsequent year but does not state the taxpayer is entitled to a net loss deduction.

Petitioners also incorrectly contend that the Court's reliance in Nolte v. Commissioner, supra, on section 1.165-13T, Q&A-3, Temporary Income Tax Regs., supra, is unfounded; they argue that the regulation is invalid to the extent it reaches a result different from the congressional mandate of DEFRA section 108(c). The Court in Nolte found that Congress designed DEFRA section 108(c) as a relief provision so that the Commissioner could not obtain a windfall by denying straddle losses and then having taxpayers recognize straddle gains resulting from the closing of a straddle. Nolte v. Commissioner, supra. Section 1.165-13T, Q&A-3, Temporary Income Tax Regs., supra, carries out Congress' mandate to allow straddle losses but only to the extent of, and against, straddle gains.

Therefore, we find that DEFRA section 108(c) and section 1.165-13T, Q&A-3, Temporary Income Tax Regs., supra, make it clear that petitioners are only entitled to offset their gains by the amount of the losses. Nolte v. Commissioner, supra; see also Ewing v. Commissioner, 91 T.C. at 421. Accordingly, petitioners are not entitled to an additional deduction for their "net" loss in excess of straddle gains.

Increased Interest Under Section 6621(c)

Respondent seeks increased interest from petitioners pursuant to section 6621(c). Petitioners have the burden of proof with respect to the additional interest. Rule 142(a).

Section 6621(c) applies where the Commissioner has established that there is an underpayment of at least $1,000 in any taxable year "attributable to 1 or more tax motivated transactions". Sec. 6621(c)(2). Section 6621(c)(3)(A)(iii) specifically includes any straddle as a tax-motivated transaction. Thus, since petitioner's Hunter straddle transactions were not entered into for profit, they are subject to increased interest under section 6621(c).

To reflect the foregoing, and the concessions made by the parties,

Decision will be entered under Rule 155.

Footnotes

FN1. Since modern gold futures trading began in 1974, gold futures have been traded on four domestic exchanges: (1) The Chicago Board of Trade (CBOE); (2) the International Monetary Market (IMM), which is associated with the Chicago Mercantile Exchange; (3) the Commodity Exchange, Inc. (COMEX), and (4) the MidAmerica Commodity Exchange. The dominant exchange is COMEX.

FN2. A short position is held by a person who has sold one or more futures contracts without having previously bought them.

FN3. A long position is held by a person who has bought and holds one or more futures contracts.

FN4. For example, if spot gold is $400 per ounce, and the interest rate is 1 percent per month, a 6-month delivery will be priced at $424 [$400 + (1 percent x 6 months x $400)]. Thus, when the number of long contracts equals the number

of short contracts, the difference in price between the long and short legs is entirely a function of the interest cost of carrying gold from one futures delivery month to the other. FN5. Petitioner was also able to offset capital gains (after such capital gains had already been reduced by the 60-percent long-term capital gain exclusion) by the amount of $56,849.

Robert G. LESLIE and Marilyn B. Leslie, Petitioners-Appellants,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent-Appellee.

No. 96-70880.

United States Court of Appeals, Ninth Circuit.

Order

Before: FERGUSON, THOMPSON, and O'Scannlain, Circuit Judges.

The petition for rehearing is denied

s/

Filed: 7/30/98

Tax Reform Act of 1984, Pub. L. No. 98-369, 98 Stat. 494

SEC. 108. TREATMENT OF CERTAIN LOSSES ON STRADDLES ENTERED INTO BEFORE EFFECTIVE DATE OF ECONOMIC RECOVERY TAX ACT OF 1981.

(a) GENERAL RULE.--For purposes of the internal Revenue Code of 1954, in the case of any disposition of 1 or more positions- -

(1) which were entered into before 1982 and form part of a straddle, and

(2) to which the amendments made by title V of the Economic Recovery Act of 1981 do not apply, any loss from such disposition shall be allowed for the taxable year of the disposition if such position is part of a transaction entered into for profit.

(b) PRESUMPTION THAT TRANSACTION ENTERED INTO FOR PROFIT.--For purposes of subsection (a), any position held by a commodities dealer or any person regularly engaged in investing in regulated futures contracts shall be rebuttably presumed to be part of a transaction entered into for profit.

(c) NET LOSSES ALLOWED WHETHER OR NOT TRANSACTION ENTERED INTO FOR PROFIT. --If any loss with respect to a position described in paragraphs (1) and (2) of subsection

(a) is not allowable as a deduction (after applying subsections (a) and (b)) , such loss shall be allowed in determining the gain or loss from dispositions of other positions in the straddle to the extent required to

accurately reflect the taxpayer's net gain or loss from all positions in such straddle.

Tax Reform Act of 1986, Pub. L. No. 99-514. 100 Stat. 2085
SEC. 1808. AMENDMENTS RELATED TO TAX STRADDLE PROVISIONS

(a) TREATMENT OF SUBCHAPTER S CORPORATIONS.-

* * * *

(d) SECTION 1O8.--Section 108 of the Tax Reform Actof 1984 is amended --

(1) by striking out "if such position is part o a transaction entered into for profit" and inserting in lieu thereof "if such loss is incurred in a trade or business, or if such loss is incurred in a transaction entered into for profit though not connected with a trade or business",

(2) by striking out subsection (b) and inserting in lieu thereof the following:

"(b) LOSS INCURRED IN A TRADE OR BUSINESS. --For purposes of subsection (a), any loss incurred by a commodities dealer in the trading of commodities shall be treated as a loss incurred in a trade or business",

(3) by striking out the heading for subsection (c) and inserting in lieu thereof the following:

"(c) NET LOSS ALLOWED. --",

52(a) Effect.

In all actions tried upon the facts without a jury or with an advisory jury, the court shall find the facts specially and state separately its conclusions of law thereon, and judgment shall be entered pursuant to ; and in granting or refusing interlocutory injunctions the court shall similarly set forth the findings of fact and conclusions of law which constitute the grounds of its action. Requests for findings are not necessary for purposes of review. Findings of fact, whether based on oral or documentary evidence, shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the trial court to judge of the credibility of the witnesses. The findings of a master, to the extent that the court adopts them, shall be considered as the findings of the court. It will be sufficient if the findings of fact and conclusions of law are stated orally and recorded in open court following the close of the evidence or appear in an opinion or memorandum of decision filed by the court. Findings of fact and conclusions of law are unnecessary on decisions of motions under or or any other motion except as provided in subdivision of this rule.

Rule 403. Exclusion of Relevant Evidence on Grounds of Prejudice, Confusion, or Waste of Time

Although relevant, evidence may be excluded if its probative value is substantially outweighed by the danger of unfair prejudice, confusion of the issues, or misleading the jury, or by considerations of undue delay, waste of time, or needless presentation of cumulative evidence.

Rule 702. Testimony by Experts

If scientific, technical, or other specialized knowledge will assist the trier of fact to understand the evidence or to determine a fact in issue, a witness qualified as an expert by knowledge, skill, experience, training, or education, may testify thereto in the form of an opinion or otherwise.

Rule 703. Bases of Opinion Testimony by Experts

The facts or data in the particular case upon which an expert bases an opinion or inference may be those perceived by or made known to the expert at or before the hearing. If of a type reasonably relied upon by experts in the particular field in forming opinions or inferences upon the subject, the facts or data need not be admissible in evidence.